

# COMMERCIAL INSURANCE MODERNIZATION

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HEARING  
BEFORE THE  
SUBCOMMITTEE ON  
CAPITAL MARKETS, INSURANCE, AND  
GOVERNMENT SPONSORED ENTERPRISES  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED NINTH CONGRESS  
SECOND SESSION

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JUNE 21, 2006

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## COMMERCIAL INSURANCE MODERNIZATION

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Wednesday, June 21, 2006

U.S. HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON CAPITAL MARKETS,  
INSURANCE, AND GOVERNMENT  
SPONSORED ENTERPRISES,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:02 p.m., in room 2128, Rayburn House Office Building, Hon. Richard H. Baker [chairman of the subcommittee] presiding.

Present: Representatives Baker, Bachus, Royce, Kelly, Kennedy, Tiberi, Brown-Waite, Feeney, Campbell, Kanjorski, Moore, Capuano, and Miller of North Carolina.

Chairman BAKER. I call this meeting of the Capital Markets Subcommittee to order, and I welcome all of our witnesses and participants today.

Just by way of advisory, Mr. Kanjorski and I were just observing the likelihood of a significant series of votes commencing around 2:30.

The staff will be visiting with those on the second panel to see if we can figure out a way to facilitate moving ahead to get all witnesses' testimony on the record.

Once we get into that lengthy consideration, we hate to keep everybody waiting around, but at the same time, we don't want to trouble you with preparation of the testimony and not have it received.

They may be visiting with some of you in the next couple of minutes to figure out how we can best manage this issue.

Today, the committee meets to discuss the need for reform in the arena of insurance, and particularly, to discuss the assets of H.R. 5637, now pending before the committee.

As is evident, the differing State regulatory structure presents considerable impairment to the development of product by not enabling competitive forces to work properly, resulting in fewer offerings to consumers and, all too often, an unnecessary increase in premiums.

Today, we focus really on a very narrow sector of the problem, the non-admitted, or what is traditionally known as the surplus lines.

These companies have become increasingly important since 9/11, as well as the unfortunate catastrophes that have impacted the Gulf States.

This is a commercial marketplace and generally viewed as being very well-developed and sophisticated, without any State price controls or requirements of mandatory coverage.

Given the sensitivity of the terrorism issue, the Port of New Orleans, the oil and gas business offshore, our shipping interests, the movement of hazardous materials, and the high catastrophic impact of hurricanes, this is of unique and considerable importance to the Members from my State.

Unfortunately, this last resort market is, in my opinion, being hampered by burdensome and conflicting rules—State rules on premium tax collection, broker licensing requirements, and over-regulation of commercial purchasers.

Re-insurance is vital to our marketplace and enabling it to function in a more efficient manner, I believe, is beneficial to us all.

I specifically want to commend Mr. Moore and Ms. Brown-Waite for their co-sponsoring, in a bipartisan way, H.R. 5637, which I think is a very targeted remedy to a clearly identified problem.

Establishing uniform tax treatment, creating a home State deferral, streamlining access to non-admitted markets, and compelling States to recognize their own re-insurance accreditation standards, are among its chief and important goals.

In the coming months, it is my intention to take a closer look at other areas of concern, such as agent and company licensing, freedom in pricing, and speed to market issues. There is much work to be done in all of those areas.

However, the surplus lines and re-insurance reform, I think, are very important and a big first step, and I appreciate all those who will be heard from today and their contribution in moving the committee work forward.

Chairman BAKER. Mr. Kanjorski?

Mr. KANJORSKI. Mr. Chairman, we return this afternoon to a topic that we have often discussed in recent years, the need for insurance regulatory reform. This time, we will focus on the issue of commercial insurance modernization.

As I have previously said, no matter what side one takes in this long-standing debate on regulatory efficiency, it has become increasingly clear to me that this is no longer a question of whether or not we should reform insurance regulation in the United States, instead, it has become a question of how we should reform insurance regulation.

As you know, Mr. Chairman, we have begun to develop a growing consensus in Congress about the need to improve insurance regulation.

During our previous hearings on insurance reform, we have also received extensive testimony from many witnesses advocating the creation of an optional Federal charter, a proposal that I believe merits our attention.

Furthermore, since our last hearing on insurance regulation, some of our colleagues in the Senate have introduced Senate Bill 2509, the National Insurance Act, to create an optional Federal charter.

Rather than overlaying Federal mandates on top of State regulations, an optional Federal charter would, in my view, create a sensible, separate, and streamlined regulatory system.



In the future, Mr. Chairman, I hope we will take the time to convene hearings on, and study the implications of, their proposal.

Nevertheless, the focus of today's proceedings is H.R. 5637, the Non-Admitted and Re-Insurance Reform Act. Many sophisticated participants in our insurance markets have complained about problems in the regulation of surplus lines and re-insurance, and H.R. 5637 seeks to address these concerns.

Large commercial entities, major insurers, and re-insurance companies all operate across State lines. They both want and need greater regulatory efficiencies. As I have learned more about these concerns about licensing, invoicing, and documenting, I have become increasingly sympathetic about the need to address them.

Before moving forward with consideration of this bill, however, we need to hear from the National Association of Insurance Commissioners (NAIC). Last year in testimony before our panel, the president of the NAIC noted that Federal legislation, "may be needed at some point to resolve conflicting State laws regulating multi-state transactions," involving surplus lines. She also observed that Federal legislation was "not needed" in the area of re-insurance.

The development of good public policy requires the input of all interested parties and constituencies. In this case, the NAIC is one very interested party. Even if we ultimately decide to disagree, we need to engage them in a constructive dialogue.

While H.R. 5637 is well-intentioned, I am also somewhat concerned that proceeding with piecemeal reform legislation like this bill could hamper future efforts to adopt more comprehensive proposals like the optional Federal charter.

In the area of health insurance, the many Federal mandates that we have imposed have made it more difficult to develop a national consensus on far-reaching reform. We should not repeat that mistake here. Nevertheless, I also recognize that we should not allow the proverbial perfect to be the enemy of the good.

In addition, I am concerned that this legislation does little to establish a Federal expertise in the area of insurance. At times, this lack of expertise has caused difficulties for us.

For example, although many Members of Congress had concerns about the insurance industry's ability to respond to the 2001 terrorist attacks, they had difficulty in immediately identifying Federal experts to advise them in these matters.

The deficiency of Federal knowledge about the insurance industry might have also impeded our efforts to adopt expeditiously the terrorism re-insurance backstop law. As a result, we may want to consider how we could improve H.R. 5637 to enhance the Federal Government's understanding of the business of insurance.

In closing, Mr. Chairman, I commend you for continuing to focus our committee on insurance regulation. These are important discussions for us to have, and important matters for us to resolve.

Chairman BAKER. I thank the gentleman for his statement.

Ms. Brown-Waite?

Ms. BROWN-WAITE. Thank you very much. I certainly want to thank you, Mr. Chairman, for holding this hearing today and look forward to hearing from the witnesses who are on the panels as well.

This subcommittee has been engaged in overall insurance reform for several years, and in this endeavor, there are dozens of issues that Congress must consider.

I have introduced H.R. 5637, the Non-Admitted and Re-Insurance Reform Act, will provide solutions to two aspects of that reform.

The bill does have bipartisan support. Today, the regulation in the surplus lines market is fragmented and cumbersome. Insurers and brokers who want to provide insurance across State lines are subject to a myriad of different State tax and licensing requirements.

For instance, if a company in Florida was to transport a product, say parts for a space shuttle, to Houston, Texas, the non-admitted insurance company they use must comply with the regulations of at least five different States.

Oftentimes, these regulations will conflict, making it impossible with today's complex situation out there, for one company to comply with all of them.

This situation leaves policyholders and underinsured individuals with little choice of providers.

Moreover, most of the companies that purchase insurance in the non-admitted markets do so every day. These sophisticated commercial entities have educated risk advisors on staff with a thorough knowledge of the market and their risk exposure.

Yet, in most States, these companies are required to shop around the admitted market and be denied several times for coverage that they know they cannot get, so they should not have to make those phone calls, and only then are they permitted to shop in the surplus lines market.

This practice is needless and cumbersome, and only adds to the cost to the policyholder.

On another front, in the re-insurance market, some State regulators are taking it upon themselves to throw out arbitration agreements between re-insurance providers and the primary carriers. These are contractual agreements decided upon by sophisticated parties on both sides of the transaction to settle disputes without tying up courts.

If these agreements are valid in a State that is accredited by NAIC, they should be valid in all accredited States. Accordingly, H.R. 5637 specifies that only the tax policies and licensing regulations of the State in which the policyholder is domiciled govern that transaction. States may still enter into tax allocation and remittance agreements with other States, but this bill specifies which law will take precedence, thus, taking the guesswork out of the process.

Insurance providers, therefore, only need to comply with the law of the policyholder's State in one transaction.

The bill also requires States within 3 years of passage to participate in the National Association of Insurance Commissioners' National Insurance Producers Database, and to adopt regulations under NAIC's Non-Admitted Insurance Model Act.

It also allows sophisticated commercial entities direct access to the surplus lines market, as well as prohibiting States from voiding

established contractual arbitration agreements between re-insurers and primary companies.

Obtaining insurance for unique or high risk products in the non-admitted market already has its own obstacles, and a quagmire of inefficient State rules certainly does not help.

With re-insurance rates at an alarming rate, companies should be encouraged to stay out of the courts and follow their own arbitration agreements.

I think that the bill provides some commonsense solutions to the non-admitted and re-insurance market, and that it enjoys bipartisan support.

I certainly thank the chairman for holding this hearing today as well as the participants in the panel.

Chairman BAKER. I thank the gentlelady for her statement. Mr. Moore?

Mr. MOORE. Thank you, Mr. Chairman. I would like to thank Chairman Baker for holding today's hearing on commercial insurance modernization, and look forward to hearing the witnesses' testimony on the specific reforms included in H.R. 5637, the Non-Admitted and Re-Insurance Reform Act.

I would also like to welcome Dick Bouhan from the National Association of Professional Surplus Lines Offices, which is headquartered across the State line from my district in Kansas City, Missouri, and also David Gates, general counsel of Generali USA, also based in Kansas City, Missouri.

Congresswoman Ginny Brown-Waite and I introduced H.R. 5637 on Monday with strong bipartisan support, and strong support on this committee; 14 of the 16 co-sponsors are members of the Financial Services Committee, both Republicans and Democrats.

The bill that is under discussion today would significantly improve the regulation of two specific areas in the commercial insurance marketplace, namely, surplus lines and re-insurance transactions.

This could sometimes, with directly conflicting State laws in the surplus lines market, create unnecessary inefficiencies and make it difficult, if not impossible in some cases, for producers and others to comply with their legal duties.

In the case of State premium tax payments in particular, the patchwork of 55 different laws in the areas of allocation formulas, tax due dates, and competing tax authorities, make little sense for the producers who place multi-state policies and the businesses that are seeking multi-state coverage.

In most States, surplus lines premium taxes are levied at the State level, but at least in one State, Kentucky, as Mr. Sinder's testimony notes, those taxes are actually levied at the city and county level as well, creating a situation in which one State alone has several hundred different taxing authorities.

In addition, 11 States and the District of Columbia have no laws stipulating how or even whether surplus lines taxes should be allocated to other States if there is a risk insured in those States.

Testifying last year in front of the subcommittee on behalf of NAIC, one insurance commissioner acknowledged the need for reform of surplus lines regulation, specifically with regard to the way premium tax allocation is handled.

According to Commissioner Diane Koken, "Either Federal legislation or another alternative such as interstate compact may be needed at some point to resolve conflicting State laws regulating multi-state transactions.

"The area where this will most likely be necessary is surplus lines premium tax allocation.

"Federal legislation might also be one option to consider to enable multi-state property risks to access surplus lines coverage in their home States under a single policy subject to a single set of requirements."

It is important to note that H.R. 5637 does allow States to enter into a compact to establish an universal allocation formula for premium tax revenues and by limiting collection of surplus lines premium tax revenues to the home State of an insured business, this legislation has a built-in incentive for States to finally create an efficient allocation method.

No State has an incentive under this bill to lose premium tax revenue.

Additionally, H.R. 5637 includes necessary reforms in the area of re-insurance. This legislation would prohibit the extraterritorial application of State laws, and allow insurers and re-insurers to resolve disputes pursuant to contractual arbitration clauses. This reform is long overdue and is necessary to restore regulatory certainty to the re-insurance market.

Other members of the subcommittee, and possibly a few of our witnesses, may want to discuss the broader issue of how insurance is regulated in this country. I think that is a reasonable and necessary discussion to have, and I know that this is something the subcommittee and full committee have examined, and will continue to examine, but for now, I look forward to considering legislation that is narrowly focused on addressing problems in two specific areas of the commercial insurance marketplace.

I thank you, Mr. Chairman, and I look forward to hearing from our witnesses today. Thank you.

Chairman BAKER. I thank the gentleman. Mr. Royce?

Mr. ROYCE. Thank you, Chairman Baker. Thank you for holding this hearing on commercial insurance modernization. It is very timely. I certainly want to thank Congresswoman Ginny Brown-Waite and Congressman Dennis Moore for introducing the Non-Admitted and Re-Insurance Reform Act of 2006.

I must say that I'm very encouraged that this committee is considering legislation to improve the regulatory environment facing insurance consumers and underwriters, because I think there is widespread agreement now that our Nation's insurance regulatory system impedes the ability of insurance consumers to have optimal coverage at the lowest possible cost.

I think if we go back to 1868, there was a misguided Supreme Court ruling at that time that insurance was not considered an article of commerce and therefore, not subject to the interstate commerce clause, but subsequent to that, of course, *Paul v. Virginia* was later overturned by a Supreme Court decision where Congress decided to leave insurance regulation solely in the hands of State legislators. We did that through the passage of McCarrin-Ferguson back in 1945.

Today, I think it is clear to many on this committee that the insurance marketplace is not only national in scope, but frankly, global in nature. The legislation offered here by Representatives Ginny Brown-Waite and Dennis Moore is prima facia evidence that Congress needs to play a role to improve efficiency in insurance regulation.

While I applaud the efforts of my colleagues to improve the re-insurance sectors here, I also believe that Congress should work to help all consumers of insurance. I believe individuals, not just businesses, would greatly benefit from more competition and choice among insurance providers.

In addition to considering this legislation, I hope that this committee, and the Members here, will consider the creation of an optional Federal charter for insurers.

I thank you again for your leadership on all of this, Mr. Baker, and I yield back, Mr. Chairman.

Chairman BAKER. I thank the gentleman. Mr. Capuano, did you have a statement? Any member? Ms. Kelly?

Mrs. KELLY. Thank you, Mr. Chairman. I really appreciate your holding this hearing. I appreciate your commitment to modernizing America's insurance market to make the industry more competitive and deliver better rates and customer service to consumers.

I was happy to help write the original NARAB legislation in 1999 that became part of the Gramm-Leach-Bliley Act. NARAB responded to the simple problem that insurance agents were spending more time doing paperwork than meeting with their clients.

Every State demanded different rules and regulations just to do business. Some of those States required paper clips. Some required staples. Some required pink paper. Some required white.

It just wasn't working very well for the consumers, the people who had an insurance agent who would move to a new home, and that meant they would lose the services of a trusted independent agent that they had worked with for years. Fifty different States found 50 different ways to make money from the agents who were trying to just take care of their customers, and it really wasn't fair.

NARAB became law in 2001 when 29 States signed onto the reciprocity between their agents. It has reduced but not eliminated the burdens on our agents.

Four of the largest States have not implemented NARAB, and some of the others have adopted requirements that erode reciprocity and move away from the uniformity that was desired.

I believe that the time has come for this committee to re-examine NARAB and see what can be done to fulfill that promise, when we have all States but four being a part of NARAB, it is time for us to take a look at what Congress can do to bring all States together.

I appreciate the fact that you are holding this hearing and I look forward to the comments of the witnesses on this issue.

Chairman BAKER. I thank the gentlelady for her statement. There being no further members with opening statements, I want to welcome each of our witnesses to the hearing. As is the usual practice, we request that you make your oral statement in 5 minutes or less. Your full written statement will be made part of the record. We do appreciate your courtesy in participating.

I am told that the votes are in the near term, and when we do get to that point, I will proceed down to about 5 minutes left, then recess. We will probably be gone about 20 minutes, just to give you some idea of the state of play as best as we know it.

It is my pleasure to welcome Mr. Tom Minkler, president, Clark-Mortenson Agency, and chairman of the Government Affairs Committee, Independent Insurance Agents and Brokers.

Please proceed, sir, at your own leisure.

**STATEMENT OF TOM MINKLER, PRESIDENT, CLARK-MORTENSON AGENCY AND CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA**

Mr. MINKLER. Thank you and good afternoon, Chairman Baker, Ranking Member Kanjorski, and members of the subcommittee.

My name is Tom Minkler and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America, and to provide my association's perspective on the non-admitted insurer/re-insurer legislation that is the focus of this hearing.

I am currently chairman of the IIABA Government Affairs Committee. IIABA is the Nation's oldest and largest trade organization of independent insurance agents and brokers. We represent a nationwide network of more than 300,000 agents and brokers and employees.

I am also president of the Clark Mortenson Agency, a New Hampshire based independent insurance agency that offers a broad array of insurance products to commercial and personal consumers in New England and beyond.

Clark Mortenson writes \$36 million of premium in eight office locations in two States. I am licensed in 14 States, and approximately 15 to 20 percent of my business is in the non-admitted or what is called the surplus lines market.

Therefore, I am very familiar with the hodgepodge of varying State requirements in this market that provide little consumer benefit.

Non-admitted or surplus lines insurance provides coverage for unique or hard-to-place commercial property and casualty risks. By this, I mean coverage that is unavailable or unaffordable in the traditional or admitted insurance market, and is sold by insurers that are not admitted or licensed to do business in the particular State where the policy is located.

This market is often described as a safety valve for the traditional insurance market. It serves an essential purpose to provide insurance to many larger commercial entities and is quite substantial.

For example, gross premium volume generated by the total surplus lines industry was approximately \$33 billion in 2004.

I have submitted a more formal statement for the record that lays out many of the problems with the current State-by-State regulations of the surplus lines market and how it negatively impacts consumers.

Today, I would like to give you some real world examples of problems that I have experienced writing coverage for commercial customers.

For example, a business client has locations in Massachusetts, New Hampshire, and Vermont that require insurance coverage through the surplus lines market; the process to obtain the proper coverage would be very different, even though the client's physical locations were within a 100 mile radius of each other.

In Massachusetts, we, the broker and the client, would have to provide certified evidence that there were no companies willing to provide coverage in the standard market, while in New Hampshire and Vermont, there is no standard due diligence step.

The filing process will be a manual process in two of those States, with Vermont requiring two separate filings to two different departments within that State. In New Hampshire, the filing is on-line.

The actual tax rate is different for each State: New Hampshire at 2 percent; Vermont at 3 percent; and Massachusetts at 4 percent.

Additionally, two States require the individual broker, myself, to be licensed, while in the third State, the corporation is the licensed entity.

I have just described the scenario for a business owner with locations in three States; imagine if they had locations in 10, 20, or even 50 States.

This brings me to the legislation before us. The Non-Admitted Insurance and Re-Insurance Reform Act solves many of the problems that I have just discussed. The legislation effectively streamlines surplus lines regulation while making the insured's home State the source of regulation for individual surplus lines transactions.

It also would streamline access to the surplus lines market by waiving State due diligence requirements for the sophisticated commercial entities that constitute a significant portion of policyholders in this marketplace.

It does not deprive any State with a connection to the risk being insured from its share of premium taxes. What it does allow is the broker to pay the taxes on a multi-state risk only to the policyholder's home State and leaves it to the State to work out the appropriate allocation.

IIABA supports the specific reforms included in this bill. Most importantly, we strongly believe that the overall approach taken by this bill is the right way to go.

This is evident by the strong bipartisan support and consensus within the insurance industry. The legislation preserves the State system insurance regulation while achieving much needed uniformity rather than choosing more extreme reforms such as the creation of a Federal regulator.

IIABA believes the best use of Federal legislative authority is to help make the existing system more efficient and uniform through a mix of national standards with State enforcement and uniformity achieved through both incentives and preemptive of certain State laws.

The SMART draft of 2 years ago would have tackled most aspects of the insurance regulatory system all at once. In contrast, this legislation would single out two areas, surplus lines regulation and re-insurance supervision, where there is general consensus for early action.

We strongly support the step-by-step approach to achieving reform.

In conclusion, IIABA applauds the sponsors of this bill, and we urge the subcommittee to promptly act on the Non-Admitted Insurance and Re-Insurance Reform Act of 2006.

If there is one message that we would like to leave with the subcommittee, it is that we believe this bill is an excellent example of a pragmatic reform that utilizes targeted Federal action to improve the State-based regulatory system.

IIABA is hopeful that H.R. 5637 will be an important first step in a process that will result in additional reforms to State insurance regulation, particularly regulation of producer and insurance company licensing.

Thank you again for the opportunity to testify today.

[The prepared statement of Mr. Minkler can be found on page 61 of the appendix.]

Chairman BAKER. Thank you for your participation.

Our next witness is Mr. Scott A. Sinder of The Scott Group, appearing here today on behalf of the Council of Insurance Agents & Brokers. Welcome, Mr. Sinder.

**STATEMENT OF SCOTT A. SINDER, ESQ., THE SCOTT GROUP,  
ON BEHALF OF THE COUNCIL OF INSURANCE AGENTS AND  
BROKERS**

Mr. SINDER. Thank you, Mr. Chairman, Ranking Member Kanjorski, and members of the subcommittee. Thank you for the opportunity to testify today. Thank you, Congresswoman Brown-Waite and Congressman Moore for introducing this legislation.

I am testifying today as the general counsel for the Council of Insurance Agents & Brokers. The Council, as many of you know, represents the Nation's top 1 percent of insurance brokerage firms. There are only 250 members, but collectively, they sell or place over 90 percent of all commercial insurance that is sold in this country.

The Council has been seeking this type of reform for decades. I want to emphasize one thing at the outset, and picking up where Mr. Minkler left off, this bill is not a de-regulation bill. This bill would simply consolidate regulation so that any multi-state transaction is subject to one, and only one, set of rules.

In the current environment, if you are a client who has exposures in all 55 jurisdictions regulated in this country, you are subject to 55 different sets of rules. As Congressman Moore pointed out, in Kentucky, there are dozens more when you add the county and municipality premium tax provisions.

The home State approach that is taken under this bill is completely appropriate. It is appropriate for this reason. If you think about surplus lines insurance, it is insurance that is placed in a non-compulsory manner. No one is required to buy it. The commercial insured's who do buy it buy it to protect their treasury. They are not protecting a piece of property in any given location. That piece of property is what secures their entitlement to monies should the property be damaged.

There are many different ways that they can insure that risk: they can self insure; they can create a captive; they can buy insur-



ance in the mini-market; or they can do so in the surplus lines market.

What they are protecting is their corporate treasury. That treasury is located in the State which is their principal place of business. The regulator in that State, therefore, has the greatest nexus to that consumer.

There are five basic areas of surplus lines regulation in every State. The basics of these rules in all States are almost the same. It is the details that vary in a way that makes it very cumbersome.

On these charts on the right, for example, is a policy that is for a national chain drug store retailer. It covers exposures in 17 States. Each State requires that on the very first page of the policy they put a disclosure notice.

The disclosure notice says that this policy is being sold by a carrier that is not admitted in the State and they are not protected by the guarantee fund of this State. They have to do that 17 times for each and every State in which the policy covers business.

They have to file premium tax statements in each and every State where the policy covers an exposure. This is a set of the premium tax filings for this client. This is for 16 States.

This client has 40 surplus lines policies. This is the filing, the premium tax filing, for one of those policies in 17 States. The broker who placed this business, Aon, has to do this 40 times for each of the surplus lines products covered in this program.

In addition to premium tax payments, which you have heard a lot about, the declination rules are when you are permitted to access the marketplace; when you can go to the surplus lines marketplace rather than place through an admitted insurer.

Every State has rules. All the rules basically say you are permitted to do so when you can demonstrate that you cannot place this risk in the admitted marketplace.

The problem is papering that. Some States require five affidavits. Some States require three formal declinations in letter form. Other States require you just to on your own basis, of your own knowledge, make a determination of whether or not it is available.

It is not satisfying the substance of the requirement that is difficult; it is satisfying the procedural one. This carries forward the carrier eligibility, broker licensing, and the other filings, the administrative filings, that are required in each State.

All of this legislation would do primarily—there are two exceptions—is require that each of those transactions would be subject just to that one single State of rules.

The two exceptions are these. One is the eligible carrier provisions that are included in the bill. Those provisions would set a national standard that would pick up on the NAIC's model act and say that everyone would use the same basic determination factors for determining whether or not a carrier is eligible to receive that business in the surplus lines marketplace.

Today, every State has a variant of these rules. To my knowledge, there is almost no carrier that is approved in all 55 jurisdictions on the surplus lines list. One reason is that most of these carriers are admitted carriers in at least one State, which takes them out of the surplus lines marketplace in that State and makes them

ineligible to receive a surplus lines placement for exposures insured in that State.

The bill would rectify that through the home State rule provision. It also would establish a national standard picking up on this NAIC rule so that everyone would apply the same basic rules. Today, 32 States already have some variant of that model in place.

The final exception is the automatic export exception, which again would allow more sophisticated commercial consumers to more immediately access the surplus lines marketplace without complying with the declination rules.

Mr. Chairman and members of the committee, thank you for the opportunity to testify today. Of course, I would be happy to answer any questions you may have. Thank you.

[The prepared statement of Mr. Sinder can be found on page 81 of the appendix.]

Chairman BAKER. Thank you very much, sir.

Our next witness is Mr. Bernd G. Heinze, executive director of the American Association of Managing General Agents. Welcome.

**STATEMENT OF BERND G. HEINZE, ESQ., EXECUTIVE DIRECTOR, AMERICAN ASSOCIATION OF MANAGING GENERAL AGENTS**

Mr. HEINZE. Thank you very much, Mr. Chairman, Ranking Member Kanjorski, Mr. Moore, Ms. Brown-Waite, and members of the subcommittee. First and foremost, Mr. Chairman, the American Association of Managing General Agents would like to commend you for your leadership of the subcommittee, and thank the sponsors of H.R. 5637.

This is an absolutely vital and necessary modernization reform effort that will keep the surplus lines industry where it needs to be and move it forward with greater protections to the consumers and those people who depend upon our marketplace for security and protection.

We commend the efforts of this committee and are very anxious to work with you and your staff members to move this effort forward.

To let you know what we have done so far, this evening, we will be sending a blast e-mail out to all of our members encouraging them to support this legislation, and also to advise their local elected representatives to send this information on to their retail producers.

We have sent information on to the National Association of Insurance Commissioners to advise the Producer Licensing and Modernization Committee and the Surplus Lines Taskforce how vital and important the Non-Admitted and Re-Insurance Reform Act is to our industry.

We are also pleased to be working with Mr. Minkler, Mr. Rusbuldt, Mr. Symington, and our colleagues at the Big I, Mr. Bouhan and our colleagues at the National Association of Professional Surplus Lines organizations in support of this effort.

We have also sent information on to the Financial Services Authority in London and all of our Lloyd's of London and market members, the syndicate members and underwriters there, letting them know how important this effort is, and we are also working

with NCOIL and the American Legislative Exchange Council to encourage them, from a State aspect, to support this effort as well.

We are very gratified to see bipartisan support of this bill and hope that our continued efforts in conjunction with those of our colleagues will help move this matter forward as productively as we can.

Mr. Chairman, we live in very uncertain times, and the American Association of Managing General Agents believes that this bill provides pragmatic reform and modernization of the surplus lines and re-insurance market to bring needed uniformity and consistency of a State-based regulatory framework while affording America's businesses and private consumers protection and access to stable markets to protect their risk exposures.

It will streamline compliance requirements while at the same time enhance efficiencies and improve on processing components in the overall insurance transaction.

Some of the key benefits and components are flexibility and the ability to respond quickly and adapt to changing market needs and those of our consumers and policyholders.

This bill will allow that to be enhanced and furthered in a great degree of speed.

The AAMGA is the Nation's largest dedicated trade association. Since 1926, we have been serving the surplus lines and wholesale insurance distribution network. Our members write in excess of \$23.9 billion of premium each year in all 50 States. Roughly, that translates into approximately 72 percent of all the surplus lines premium that is written in the United States today.

We feel that we have a great degree of opportunity to work with you, Mr. Chairman, to continue the focus to modernize commercial insurance markets and thereby implement procedures and regulations that will enhance uniformity and competition while maintaining the State-based system of insurance regulation and the surplus lines market's fundamental precept of freedom from rate and form to benefit consumers and businesses in the protection of their risk exposures.

There are certain fundamental aspects in everyday practice and operation that this bill will help our members and the surplus lines industry complete.

That would primarily be to enhance the speed to market of new and needed insurance products and services.

Mr. Chairman, you mentioned the advent of the hurricanes last year, the fires in California and Texas, all those things as Ms. Brown-Waite mentioned with the space shuttle and transactions that occur in the State of Florida, where the admitted markets may not be as interested in coming into the market right away with products and services.

The surplus lines market can afford great opportunities to respond to those needs.

This bill will also stimulate open competition in the creation of innovative risk products, specifically addressing or manuscripted to the needs of the consumer, establish and mandate an uniform simple tax allocation formula and system for multi-state risks, making the payment of proportional tax more equitable and efficient.

It will facilitate uniform and consistent compliance requirements for surplus lines' agents and brokers now that the insured's home State will have authority and regulatory primacy, and will encourage individual initiatives towards sustained growth to protect increased risk exposures.

Along with our independent claim professional members and our colleagues at the American Association of Independent Claim Professionals, who also see the need for strong reform efforts to break down antiquated State barriers, we are very encouraged by this legislation.

In conclusion, Mr. Chairman, I would just like to state that we all know that insurance is the DNA of capitalism and free market entrepreneurship. It provides the ability of varying needs of security from risk and stimulates the growth of business opportunities, provides incentives for research and development that help create jobs and positive returns on investment and equity.

For the public and the private consumer, H.R. 5637 will afford continuity and recovery from fortuitous events based upon terms and conditions of coverage, and will enhance the surplus lines market overall.

Thank you again very much, Mr. Chairman, for giving us the opportunity to testify today. We will also be very happy to answer any questions you have and to continue our work with your committee and staff as we move this legislation forward.

[The prepared statement of Mr. Heinze can be found on page 56 of the appendix.]

Chairman BAKER. Thank you, sir. We appreciate that willingness to be of assistance.

Ms. Ochenkowski, if I may suggest that the committee now recess so that you do not have to rush through your statement. We are down to just about 5 minutes on the vote. I expect we would recess for about 20 minutes and then come back and pick up where we have left off.

The committee stands in recess.

[Brief recess]

Chairman BAKER. I would like to reconvene this meeting of the subcommittee and express appreciation to all of our participants. This will be the last break for the afternoon. I am sure that members will trickle back in as we proceed.

In order to make the best use of time, I would like to go ahead and call on Ms. Janice Ochenkowski, senior vice president, Risk Management, Jones Lang LaSalle, appearing today on behalf of the Risk and Insurance Management Society.

Welcome.

**STATEMENT OF JANET OCHENKOWSKI, SENIOR VICE PRESIDENT, RISK MANAGEMENT, JONES LANG LASALLE, ON BEHALF OF RISK AND INSURANCE MANAGEMENT SOCIETY**

Ms. OCHENKOWSKI. My name is Janice Ochenkowski, and I am the vice president of the Risk and Insurance Management Society, known as RIMS, which is the country's largest professional risk management association.

I am also the senior vice president and director of Global Risk Management for Jones Lang LaSalle, which is a commercial global

real estate and financial services company located in Chicago, Illinois.

I appreciate the opportunity to appear before you today on behalf of RIMS to speak about the issue of modernization of commercial insurance.

RIMS is in a very unique position to participate in this hearing because we represent the commercial consumers of insurance. Our members, roughly 4,000 companies, represent corporations, public entities, and municipalities who buy insurance.

We have a strong view on how the process should proceed, and we support the modernization of commercial insurance in this bill.

Operating on a global basis as the primary insurance buyer for Jones Lang LaSalle, I see every day the numerous inefficiencies in the current State-based system.

Commercial consumers should not have to deal with this hobbled system. We should use the proposals within this bill to address current inefficiencies.

I applaud the members of the subcommittee for presenting us with this Act, which we believe is a meaningful blueprint for reform of the surplus lines insurance.

RIMS believes that the Non-Admitted and Re-Insurance Reform Act of 2006 is necessary to address the regulatory problems that are causing disruptions in the surplus lines insurance market.

My colleagues on the panel have discussed a number of them with you already. However, I can explain from the purchaser's perspective one additional aspect, the manner in which applicable taxes are sent to the various States.

As previously noted, there are three different mechanisms. In some States, the broker is able to calculate and transmit taxes on my behalf. In other States, the broker is able to calculate but may not transmit the taxes, and in a third grouping of States, I must calculate and transmit the taxes.

The way the system works is that we collect premiums. My company is a property manager and a licensed pension advisor. Our responsibility is to purchase insurance on behalf of our client properties, more than 400 buildings in over 30 States.

We collect the premium from each property, and because of certain ERISA provisions, we are not able to co-mingle those 400 checks into a single account, but must send out 400 checks to our insurance broker.

The broker separates the premium from the tax, pays those taxes which it can, and returns to us the funds for those taxes which we must pay ourselves, with a list of the States for which we must do the calculations.

We then must issue a third set of checks in order to transmit the payments to the States. This is the same money that has gone back and forth 3 times before we can finally pay our tax bill.

There has to be a better way to do this. We believe that many States have also implemented the licensing rules that discriminate against out-of-State agents and brokers, and require our brokers to pay local brokers to stamp approval on an already negotiated insurance program.

In RIMS' perspective, in the free, open, and transparent market, risk managers will be able to negotiate the best rates, best terms, and best conditions for the coverage needed by their companies.

Currently, the surplus lines policy rates and forms are not regulated by the States, and we think it is prudent to include freedom from rate reform and regulation for surplus lines policies in a Federal statute governing the commercial property and casualty insurance, because we think it would promote a more competitive marketplace.

Some States require that before an insurance buyer can obtain insurance, a diligent search of authorized insurers must be made. This slows the procurement process and at times adds costs that are eventually passed on to purchasers. RIMS believes that this process should be streamlined.

The Non-Admitted and Re-Insurance Reform Act of 2006 provides answers to problems commercial insurance buyers are experiencing in obtaining surplus lines insurance by placing the authority in the home State of the insured. We support this and believe it will allow sophisticated commercial policyholders to proceed with the purchase of insurance and maintenance of the risks in an appropriate manner.

RIMS would also offer to provide the subcommittee with some recommendations improving the exemption provision of this bill. We strongly support the Non-Admitted and Re-Insurance Reform Act of 2006, and look forward to working with your committee and Congress on this important piece of legislation.

We thank you for your time, your interest, and your leadership in this matter. Thank you.

[The prepared statement of Ms. Ochenkowski can be found on page 76 of the appendix.]

Chairman BAKER. Thank you very much.

Mr. Sinder, I would like to start, since you brought the document trail there, there is an ad on television now where the guys are all sitting around the table trying to figure out how to save money, and somebody says what about all this and what does it cost, millions.

Without giving product attribution, what does all that cost? Is there a way to assign the duplicative regulatory compliance, not in a dollar amount, but at some percentage of costs allocable to all of that?

Mr. SINDER. I am going to divide it into several categories of costs. There are raw administrative costs. There is paper. Not to make light of it, but to do this 40 times for the 40 different policies is enormously expensive, as Ms. Ochenkowski said.

Chairman BAKER. Ochenkowski.

Mr. SINDER. Ochenkowski. I apologize.

Chairman BAKER. Don't worry. I had to be coached a little bit myself. I am not bragging or anything.

Mr. SINDER. I think you also lose your speed of access to this marketplace, which means it is not as utilized as much as it should be, and even when it is, I think it means that you have lag time in getting the policies to the consumers who most need them, so you lose what you are supposed to be getting in terms of the insurance coverage.

I think you can sort of divide it into those two groups.

Chairman BAKER. It would seem to me in a technology-driven world, paper registration—I am a big advocate in the SEC world of business reporting language, which is a technology based reporting methodology for financial institutions and hopefully for all public operating companies—to have that kind of mail activity going on has to have a significant effect on the bottom line of the companies that are required to file.

If it is possible to achieve some guesstimate of what that relates to, it would be helpful for the committee to get its hands on some substantive dollar figure or percentage that might be out there in the industry to help us get ahold of it.

Mr. SINDER. Mr. Chairman, we can poll our surplus lines placing brokers and get that information and submit it to you after the hearing.

Chairman BAKER. That would be terrific.

I might note that there have been some who suggest that we should wait on the coalitions of State actions, compacts. I have had various meetings with the NAIC over the years in getting new timelines for reform.

This type of what appears to be generally agreed upon, consulted with all stakeholders' type of approach, still has not been done as a result of that State coalitional approach.

My point being if this works out and appears in operation to be as successful as all of us hope, is not there some legitimacy for—I will go back to an earlier proposal I had called the SMART Act, which was trying to move product approvals to the national level, keeping consumer protections at the State level. It turned out to be the not-so-smart approach.

Is this a test program for seeing how we can get a more nationalized product approval system in place? All of the arguments I have heard previously against the SMART Act would seem to be applicable here.

What am I missing? What is so unique? Is it only that this does not apply to mandatory coverage, or are there other reasons why this is acceptable generally to stakeholders, where a similar approach might not be acceptable in another direction?

Mr. SINDER. Mr. Chairman, if I may. One difference between this and some of the other provisions in the SMART Act, which doesn't speak one way or the other about those provisions, is you do not need any Federal standards here.

By virtue of the fact that you are really going to rely on the home State regulator, you are not really affecting those rules as they are in place, so it is very easy to effectuate these provisions.

We have been supporters of the SMART Act and all of its provisions. We remain supporters of them.

I think this is even easier to effectuate than many of the other provisions.

Chairman BAKER. If this is effectively implemented, does that give comfort that the SMART Act provisions might be more palatable going forward, or is it in any way related?

Mr. MINKLER. Mr. Chairman, I would say from our position that this is actually the beginning of the expansion of SMART, even though it has taken two pieces of that. This is exactly the model

that we would look forward to in other areas, in license reform, reciprocity from States, those types of things.

We think that this is the perfect solution and is the perfect model for the other tenants of SMART.

Chairman BAKER. Any counter opinion to that?

Mr. HEINZE. No counter opinion, Mr. Chairman, but from our perspective, we agree that breaking up into the various increments that SMART had contained and going after matters like this is the appropriate time. It is the right policy. It is the right legislation to move this matter forward.

I once had a judge tell me in a very adversarial process back in my lawyer days when we were contrasting each other with briefs and motions, he said Mr. Heinze, I wonder how many more trees must die so that this litigation may live. This is absolutely unnecessary.

We need to afford the consumers, we need to afford this industry, the opportunity to access the surplus lines market easily, to afford protections of security, and to come into where risk exposures now are either self-insured or not insured, as well, as a result of this type of regulatory morass, which we believe H.R. 5637 will help correct.

Chairman BAKER. Thank you. I think our past actions up here have been to go out and buy fertilizer to put on the trees. I don't know how we can make it more complex.

Mr. Bachus, did you have questions?

Mr. BACHUS. I would like the panel to elaborate about the importance of re-insurance and non-admitted insurance, particularly in light of 9/11 and the hurricanes that have hit our coasts, and why this legislation is particularly critical at this junction.

Ms. OCHENKOWSKI. I can answer on behalf of the buyers of insurance. Many of the larger, more complicated risks are risks that the traditional standard insurance marketplace is not willing to cover.

We must go to the surplus lines market in order to adequately protect those risks. Being able to do so in an efficient, economical way is in the best interest of us as consumers, and it keeps the process moving in a smoother fashion.

Mr. SINDER. As I understood the question in terms of the surplus lines piece, I think it is vital for natural catastrophe exposures and tree exposures, even for non-complex commercial risks like homes, more and more on the Gulf Coast, once you get above the flood program limits, the rest of the coverage that is needed for homes is provided through the surplus lines marketplace in many cases.

This bill, for a homeowner in Alabama, would have no direct effect, because that policy placement would continue to be regulated by the Alabama rules.

What the program really does do, what the bill would do in the surplus lines marketplace is it would bolster the surplus lines marketplace overall, and by making it stronger, you would expand the capacity. That capacity would be available not just for the very complex risks, as was discussed, but also for others who need access for the more unusual type risk, like the flood exposures.

Mr. HEINZE. Mr. Bachus, Mr. Nutter from the Re-Insurance Association of America is on the next panel after us, and I am sure he will have some information for the subcommittee with regard to



re-insurance aspects from the surplus lines initiative and from what our members see, this bill will preclude the extraterritorial application of State laws to preserve the certainty of re-insurance contracts which are so vital now in this risk economy and environment that we live in.

We believe Mr. Nutter's comments will add additional information for the record.

Mr. BACHUS. I appreciate that. We had hearings back on June 4th, 11th, and 18th, of 2002. There was consensus then that we needed this legislation. I think that in light of recent events, it is even more critical.

I do see us getting to the point of where, without this insurance, without this legislation, we will be denied coverage just in the standard markets moving forward.

I think it is certainly beyond the critical point. I do think, as you say, the States' willingness to assert extraterritorial jurisdiction is really the essence of the problem.

I would praise Chairman Baker and Congresswoman Ginny Brown-Waite for bringing forth this legislation, which has bipartisan support. I would think that the leadership would give it a strong priority in moving it over to the Senate.

I have no further questions, unless there is anything that you, as panelists, would like to tell us, other than your testimony, something that has come to light.

Mr. MINKLER. At the risk of being redundant with my colleagues, I think that with this legislation and the issues that you have addressed, not necessarily in the main insurance level but in the secondary market, the surplus market, I think the efficiencies that would be provided through this legislation for the consumer to get to this marketplace and expand this marketplace would serve all of us well, including the consumers.

Mr. BACHUS. All of these costs are passed on to the consumer, ultimately. We are concerned because of rising rates, and because of rising risks. It is in need of some relief.

Chairman BAKER. I thank the gentleman for his comments. Ms. Ginny Brown-Waite.

Ms. BROWN-WAITE. Thank you very much. As you can tell, we all should be much thinner than we are because we have run from one meeting to the next to vote.

I just have a question, and that is do those who write in the non-admitted market tend to focus on a region or a type of product or both?

Mr. MINKLER. Speaking from the practitioner's standpoint, the answer is yes to all the above. There are a variety of appetites, if you will, at the carrier level, both geographically, and for the class and type of risk involved.

There are some insurance companies that focus on certain classes to the exclusion of others. To a great extent, there is an appetite that goes across the board and across regions, too.

It is kind of a convoluted answer, but it is truly a mixed bag, if you will.

Mr. HEINZE. Ms. Brown-Waite, from the standpoint of the agents and brokers, there are many who are writing in one geographical area or in one State, but most are now multi-State operations,

where they do concentrate their operations by area of specificity, by line of business.

For instance, there may be an agent or broker that specializes in day care centers or nursing homes, or as you mentioned before, the transportation of space products in Florida, or homeowner risks that are prone to catastrophic events along the shorelines of the United States.

There will be specialists in those areas. There is a niche market which has developed in the surplus lines marketplace that really, again, translates and underscores the need for your wisdom of having introduced this Act to bring uniformity, certainty, and consistency, so that all States can operate under the same type of principles, and the consumer can obtain the protection they need at the price they can afford, so that competition can rein supreme in this entrepreneurial environment.

Only in that way can we generate growth and development in this market sector, and give investors the type of confidence and comfort they need for their additional and continued investments.

Chairman BAKER. I thank the gentlelady. Mr. Moore?

Mr. MOORE. As you all know, under the direction of NAIC, the States have been trying to reform the commercial insurance market for many years. So far, their efforts have not been successful.

Will the States be able to make any meaningful regulatory changes in the area of surplus lines and re-insurance regulation without Federal legislation like the bill before us today?

Any one of you, I would like to hear from you, please.

Mr. SINDER. Congressman, I believe the answer to that question is absolutely not. The first surplus lines taskforce of the NAIC started in the mid-1980's. They had models that they have tried to enact across the States, but they have been unsuccessful.

There have been proposals to do a tax compact. They have been rejected as recently as the most recent NAIC meeting.

As you pointed out in your opening statement, even Commissioner Koken, in her role as president of the NAIC, expressed extreme doubt that they would be able to do it without Federal guidance.

Mr. MOORE. Thank you. Any other witnesses wish to make a statement?

Mr. MINKLER. Yes, Congressman. I would say that with the passage of NARAB a few years ago that Congresswoman Kelly mentioned before, we have seen incremental increases in cooperation amongst the States, but we are nowhere near where we need to be.

This is exactly the type of legislation model that we need to move ahead with what the intent of NARAB was back then, including and broadening in future legislation licensing and that type of thing.

Mr. MOORE. Thank you.

Ms. OCHENKOWSKI. Representing the consumer, and from our perspective, I do not believe that they would be able to get together in order to present or to handle this issue in any unified manner.

Mr. MOORE. Thank you.

Mr. HEINZE. Congressman, when Chairman Baker and Chairman Oxley construed the SMART Act several years ago, one of their

opening statements was that this was not supposed to be Federal preemption but Federal guidance.

While we have great confidence in the National Association of Insurance Commissioners, and their leadership, and the things they are working on with the surplus line agents and brokers that we represent, this would be great additional guidance for them to have a consistent place, a uniform structure with which they could all operate, and I do not think we would find much opposition from them either.

Mr. MOORE. My thanks to all of the witnesses. Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Moore.

Mr. Campbell?

Mr. CAMPBELL. No questions.

Chairman BAKER. Does any other member wish to be recognized? If not, at this time—one other point of clarification, just as to how the process works.

For an insured to access the surplus lines, I understand they have to be denied coverage for whatever is sought three times, and then can move to the surplus market, but if we do not pass the bill now pending, there is still the right under the current regime for a State commissioner to deny access to the surplus line carrier.

Is that a correct characterization? My belief is that the bill enables the surplus lines to respond to that capability without having to rely on a jurisdictional approval.

Is that correct?

Mr. SINDER. It is absolutely true with respect to specific carriers because of the eligibility rules. It is also true, I believe, that some commissioners issue letter rulings that say for certain types of insurance, they are going to deem it not available, and for other types of insurance, they are going to deem it available, so they can do exactly what you suggested.

Chairman BAKER. In my case, where we have a Hurricane Katrina effect and insurers withdraw, then there may be an opportunity upon an appeal and a demonstration that there is no alternative choice for a surplus lines' remedy in that case.

Mr. SINDER. The inanity of many of the States' rules is that even in a jurisdiction like Louisiana, where you know that coverage is not available, you still may have to demonstrate on a policy-by-policy basis that you were not able to get it. For each policy that you seek to place, you need to satisfy the declination requirements.

Chairman BAKER. Terrific. Thank you very much.

I want to express my appreciation to the panel for your contribution, and we expect other members to have follow-up questions, so we will keep the hearing record open for 30 days. Thank you.

If I can ask our next panel to come forward when convenient.

I want to welcome the members of this panel to our hearing. As is always the case, we ask that you try to constrain your oral presentation to 5 minutes. Your written testimony is part of our official record. We welcome you here to the committee's consideration.

Our first witness is Mr. Franklin W. Nutter, president, Re-Insurance Association of America. Welcome, sir.

**STATEMENT OF FRANKLIN W. NUTTER, PRESIDENT,  
REINSURANCE ASSOCIATION OF AMERICA**

Mr. NUTTER. Thank you very much, Mr. Chairman.

The Reinsurance Association is a national trade association representing property and casualty organizations that specialize in re-insurance.

I am pleased to testify today on H.R. 5637, legislation to streamline the regulation of non-admitted insurance and re-insurance.

The RAA supports the principles of this legislation. I would like to highlight certain aspects of it that we think are particularly important.

The RAA applauds Representatives Brown-Waite and Moore for addressing a key improvement in the efficiency of regulation of re-insurers, and that is the elimination of the extraterritorial application of State laws.

As a result of our 50 State system of regulations, significant differences have emerged among the States with respect to re-insurance regulatory requirements. The NAIC and State regulators are to be applauded for their efforts toward greater uniformity in the adoption of model laws and regulations and the creation of a system of accreditation for States to meet minimum standards for regulation.

Unfortunately, this has not prevented the States from pursuing varying and sometimes inconsistent regulatory approaches to re-insurance. One of the best examples of this is the extraterritorial application of State laws. Approximately 14 States in the re-insurance area apply their laws on an extraterritorial basis, meaning that the State law not only applies to insurers and re-insurers domiciled in the State, but to all insurers licensed in that State.

The RAA strongly supports the principle set forth in Title II, section 201, that addresses these inefficiencies. This provision retains the ability of State insurance regulators to regulate their domestic insurers and re-insurers and the re-insurance transactions of their domestic companies.

The Act simply preempts the extraterritorial application of State law and articulates the type of laws that States cannot apply on an extraterritorial basis.

Secondly, the RAA supports the principle set forth in Title II, section 202, that provides that the State of domicile of a re-insurer shall be solely responsible for regulating the financial solvency of the re-insurer if the State is an NAIC accredited State.

Allowing the State of domicile of the re-insurance company to be the single regulator for solvency will help streamline re-insurance regulation significantly and will add much value to the value of the U.S. re-insurance license.

Because the NAIC requires that accreditation laws be substantially similar, all accredited States have the same basic solvency protections and laws in place, even if they may differ in the details.

This legislation keeps re-insurance solvency regulation intact. It does relieve the re-insurer from having to file supplemental, and at times inconsistent, financial information in as many as 50 States, yet provides all States with access to financial information on the U.S.-licensed entity.

The third point that I would like to make is that the RAA does support the principle set forth in section 202(b)(3) that the credit requirements of the domicile of the re-insurer should be exclusively applied to allow the ceding insurer to take financial statement credit in all other States.

To achieve uniformity in the ceding companies financial statement requires a single State's credit statutes to apply. The NAIC's accreditation system and model credit for re-insurance law seek to achieve this result.

This statutory provision will achieve the uniformity needed by ceding companies and re-insurers.

The RAA supports this legislation, and stands ready to work with the committee to see that this legislation does move forward.

We believe that re-insurance regulatory reform will improve the value of the U.S. re-insurance license and strengthen financial regulation. Thank you very much.

[The prepared statement of Mr. Nutter can be found on page 68 of the appendix.]

Chairman BAKER. Thank you, sir. Our next witness is Mr. David Gates, senior vice president, general counsel and secretary, Generali USA Life Reassurance, on behalf of the American Council of Life Insurers. Welcome.

**STATEMENT OF DAVID A. GATES, SENIOR VICE PRESIDENT  
AND GENERAL COUNSEL/SECRETARY, GENERALI USA LIFE  
REASSURANCE, ON BEHALF OF THE AMERICAN COUNCIL OF  
LIFE INSURERS**

Mr. GATES. Thank you, Mr. Chairman. It is my pleasure to be here this morning, and I would also like to thank Mr. Moore for his welcome. I would point out that I live on the Kansas side and he is my representative, so thank you.

Today, I am here to speak on behalf of H.R. 5637 as a representative of the American Council of Life Insurers. In that organization, I serve as the vice-chair of the Re-Insurance Committee.

Additionally, as part of my background, I would point out to you that for a number of years, I served as an insurance regulator in the State of Nevada. I also served as a member of the NAIC's Executive Committee, and I served as the president of the NAIC in 1989.

I have experience on both sides of the lines on these matters, and I hope to bring that to bear in this testimony.

First off, I would like to point out that the testimony that we are delivering here today is not directed at the individual regulators themselves who by and large try very hard to do the best job they can.

Unfortunately, they are laboring in a system that at this point is becoming increasingly unresponsive to a global insurance industry with global capital flows and interrelations that, at this time, they do not have the resources and capabilities to administer.

A few points about life re-insurance, which you will find a little bit different than some of the other forms of re-insurance in the insurance marketplace.

First, re-insurance is a long term relationship. Our contracts are measured in terms of decades. Additionally, this is, as has been

pointed out, a commercial transaction on a business-to-business relationship, most often negotiated with the actuaries of the life insurance company, negotiating on an iterative basis with the actuaries of the re-insurance company.

It is hard to fathom a relationship that is more of a commercially sophisticated transaction and negotiation than that type of activity.

Additionally, the availability of re-insurance is becoming increasingly vital to the life insurance industry in the United States. Today, approximately 50 percent of the risk that is assumed by life insurers is ceded into the re-insurance market.

As of the end of 2005, there are approximately \$5.9 trillion of life re-insurance in force in the United States.

Turning to the issues of regulation and the need for greater certainty and a more level playing field, which is an absolute vital necessary, as has been pointed out by many of the other witnesses this morning, the examples of some of the issues that we are encountering at this point is a circumstance where we have a re-insurance transaction that is engaged, that has activities that are subject to both New York's and California's jurisdiction.

We will have a circumstance where we will need a bank issued letter of credit. We go and obtain a bank issued letter of credit, but the form of the letter of credit that is acceptable in the State of New York is rejected by the State of California.

Additionally, we routinely find that we encounter what are euphemistically called "desk drawer rules" in the insurance industry. These are preferences on the part of the insurance regulators, as opposed to statutes or regulations that are supposed to be regulating our industry.

Additionally, in the life insurance arena, we find that the regulatory environment that we operate in is falling increasingly further and further behind those of other financial services sectors.

For example, the 1985 series of statutes that deal with the transfer of risk require a one-size-fits-all re-insurance structure.

When I, as the re-insurer, go to negotiate with a ceding company, I am unable to tailor my re-insurance to the particular needs of that ceding company. I have a statutory mandated re-insurance structure that I must use, and I cannot, as I pointed out, tailor my offering to the needs of that particular company.

The ACLI supports the efforts of this committee, and we hope this initiative will move forward.

[The prepared statement of Mr. Gates can be found on page 50 of the appendix.]

Chairman BAKER. I thank you, sir. I appreciate your testimony and your contribution.

Our next witness is Mr. Richard M. Bouhan, executive director, National Association of Professional Surplus Lines Offices. Welcome, sir.

**STATEMENT OF RICHARD M. BOUHAN, EXECUTIVE DIRECTOR,  
NATIONAL ASSOCIATION OF PROFESSIONAL SURPLUS  
LINES OFFICES, LTD.**

Mr. BOUHAN. Thank you very much, Mr. Chairman. Chairman Baker and members of the committee, particularly Congressman

Moore, thank you for the welcome. I, at least, was born in Kansas. I live across the line, but I was born in the Jayhawker State.

My name is Dick Bouhan, and I am the executive director and general counsel of the National Association of Professional Surplus Lines Offices, known as NAPSLO. I am pleased to be here today to offer testimony on H.R. 5637, the Non-Admitted and Re-Insurance Reform Act of 2006.

NAPSLO is a national trade association representing the surplus lines industry and the wholesale insurance marketing system. NAPSLO is the only association to represent both surplus line companies and brokers, and in that context, we represent the surplus lines marketplace.

NAPSLO, and its board of directors and over 800 members, are encouraged by the initiative that the committee has demonstrated, particularly the leadership of you, Chairman Baker, and Representatives Ginny Brown-Waite and Dennis Moore, by introducing this important and timely piece of legislation. We are pleased to offer our unwavering support.

NAPSLO has been a proponent of State insurance based regulation. Surplus lines is a product of the State-based regulatory system. Unfortunately, the 50 State system has gone askew, and is now fraught with inconsistency and problems.

Over the years, NAPSLO and other industry stakeholders have worked with the NAIC to try to overcome the inefficiencies. It is clear that the time has come for Congress to intervene before these problems substantially undermine the ability of the surplus lines market to function effectively.

Chief among NAPSLO's concerns is the inconsistent way in which States manage their premium tax allocation remittance requirements. The proper allocation and remittance of surplus lines premium taxes to the States on multi-State risks has been a growing problem for decades, as the number of multi-State risks increases.

The failure of the States to establish a uniform and consistent method of remitting these premium taxes has caused confusion and complexity in the marketplace.

The genesis of this problem lies in the conflicting and inconsistent State tax laws. NAPSLO is pleased that the subcommittee has recognized the problems associated with the premium tax allocation remittance system and has incorporated a common sense solution into the bill.

This legislation creates an uniform system of premium tax allocation and remittance and authorizes States to enter into a compact as a means of harmonizing various State laws.

Let me clarify that the proposed system for tax allocation remittance in no way changes the broker's obligation to remit premium taxes to the proper State tax authority. Rather, it brings clarity and certainty to a system that is fundamentally flawed and in need of repair.

NAPSLO is also pleased that the bill creates a system of home State deference for surplus lines insurance transactions. Without home State deference, the surplus lines policy covering exposures in multiple States would subject the broker to multiple compliance requirements.

To illustrate my point, consider a broker who has a policy with five exposures in five different States. This requires the application of five separate laws and five different tax filings. It also requires compliance with five different diligent search standards and five different licensing requirements, and also the provision of five different warnings, as was demonstrated earlier in Mr. Sinder's presentation.

Now, imagine how this problem would translate nationwide with a policy with exposures in 50 States.

The bill mandates that no jurisdiction other than an insured's home State may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate surplus lines insurance.

NAPSLO is encouraged that this important concept has been included in the bill.

Finally, NAPSLO is encouraged by the subcommittee's determination that access to the surplus lines marketplace should be streamlined for the sophisticated commercial purchasers, as defined in the bill.

This legislation will provide more efficient access to the surplus lines market for sophisticated buyers to meet their unique insurance needs.

The bill also establishes safeguards by including disclosure requirements that inform sophisticated buyers of the nature of the transaction and secures their written permission prior to any coverage placement in the surplus lines marketplace.

This legislation is the right policy at the right time. H.R. 5637 is the correct approach. Again, NAPSLO commends Chairman Baker for his leadership, and for holding this hearing, and thanks Representatives Brown-Waite and Moore for introducing this important piece of legislation.

We look forward to working with the subcommittee as this bill moves through the legislative process.

I thank you for your time and attention regarding this complex and crucial segment of the insurance industry, and I stand ready to answer any questions that you might have.

[The prepared statement of Mr. Bouhan can be found on page 40 of the appendix.]

Chairman BAKER. Thank you, Mr. Bouhan.

I would like to start with Mr. Gates. In your testimony, you made reference to a statutory constraint on your ability to tailor a re-insurance product to a particular customer. Could you elaborate for me that particular concern? I am not sure I understand that.

Mr. GATES. I would be glad to. In 1985, under the guise of an NAIC model law, there was a development of a regulation called the risk transfer rule. In the risk transfer rule, it specifies that when there is to be a life insurance transaction—excuse me—a life re-insurance transaction assuming risk from a life insurer, we have to do a specified structure for that particular contract.

It tells me various types of language that I have to have in the agreement. It tells me the risks that I have to transfer in that agreement, and it effectively constrains my ability to come into a particular company and do something specific to their needs.

Chairman BAKER. Regardless of what the customer wants?



Mr. GATES. Right. I will give you an example from our days when my predecessor company actually wrote individual life insurance. We were going into the marketplace. We wanted a particular product that would have allowed us to transfer the risk inherent in certain equity indexed annuities.

What we needed to transfer was the risk revolving around the subject of the market fluctuations. We were able to go out and find a company that specialized in that type of risk, a company that had a hedging operation in its investment operation, that was very excellent at doing those types of things. We secured that re-insurance, but we could take no credit for it on our financial statements because it was outside the boundaries of what was allowed for under those rules. We did it as prudent management of our company, but again, because of the strictures of the laws, we were unable to take credit for it.

Chairman BAKER. We are going to need to get together with lawyers and see if we cannot address that. That is just nuts. There is no reason why a willing buyer and a willing seller cannot get together on the terms of a deal without government constraint standing in the middle, particularly when there is no public policy purpose served by the constraint, or is there?

Mr. BOUHAN. The regulators would say to you that there needs to be some assurance that effectively all of the risk is being transferred, but I believe that even today, the insurance regulators recognize that a more discerning regulation, a more flexible standard, can be and should be developed that allows you to tailor the particulars of a transaction to—

Chairman BAKER. But those regulators do not worry about any other counterparty risk, and whatever rates you are charging the insurer is not a subject of their review, and that is more to the core of the consumer interest in that argument.

Mr. BOUHAN. I would absolutely agree with you. Please don't take my comments as anything more than an attempt to inform you. I do not agree with their approach.

Chairman BAKER. No. I took it only as instructional, not as persuasive. Thank you.

Mr. Nutter, on the effect of the bill and specific to the arena of terrorism re-insurance, is there any identifiable benefit to the adoption of the proposed Act to enable the market to function more efficiently?

The Administration, of course, has had grave concerns about TRIA, its extension, wanting the market to function, and unfortunately, at this point, market function has not been all that significant.

Is this in your judgment an Act that will enhance capital formation in that arena?

Mr. NUTTER. It's an excellent question. Certainly, individual companies look at the exposures they write, particularly in the area of terrorism, and make some judgment about their willingness to commit capital to write a risk that many insurers and re-insurers would view as not insurable in the traditional sense.

Indeed, TRIA has been a particularly valuable piece of legislation to give insurers and re-insurers the opportunity to work within the context of the retentions that the companies have.

The efficiencies that are contained in this proposal, this bill, will make it more appropriate for companies to commit capital in the United States to a licensed entity. It would go beyond my ability to say that companies are going to commit to writing terrorism risk. I cannot say that. I could say that the efficiencies associated with a single regulator and eliminating the extraterritorial application of laws will indeed reduce the cost and inefficiencies in the current State system of regulation.

Chairman BAKER. We, at least, are not going to make it any worse. I think that is a safe conclusion.

Mr. NUTTER. We can certainly make it better.

Chairman BAKER. Thank you. Mr. Moore?

Mr. MOORE. Mr. Bouhan, can you talk a little bit about the work you have done with NAIC's surplus lines working group regarding the establishment of non-admitted insurance model laws?

I know that NAIC has tried over the years unsuccessfully to try to resolve the inconsistencies that currently exist in these States.

Mr. BOUHAN. Let me first speak to the tax issue, which I have been working with the NAIC on for four iterations of it, probably over the last decade-and-a-half.

One was an effort to try to set up a clearinghouse mechanism, electronic clearinghouse mechanism, and two other efforts have been to try to set up a harmonization of the underlying laws.

In all three instances, these have not been successful. The most recent one is our proposal that NAPSLO put forth to the NAIC to establish an interstate compact, and we have had that out before the NAIC for over a year. There was a hearing, as mentioned earlier, a hearing about this at the NAIC meeting before the surplus lines taskforce about a week ago, and the whole idea was sort of panned, I would say, by the surplus lines staff, and I think "panning" might be a kind phrase.

We have just not been successful in getting them to try to deal with this issue of harmonizing the laws, particularly for the payment of taxes. You have heard ad nauseam about the problems, and they are real problems. They just do not seem to want to get together to address this problem.

The same way with the multiple State compliance. That is another issue which is starting to raise its head because more and more brokers are getting licenses on a non-resident basis in more and more States, and now they are subject to the multiple compliance in all these States, and the NAIC does not seem to want to really address that issue at all. That was part of our compact proposal, too.

It has been a very difficult time to get them to deal with the problems. I think, in all fairness, it is 50 States trying to come to a single conclusion and trying to harmonize different laws with different policy ideas as they see them. It becomes a very difficult problem to solve.

Mr. MOORE. Thank you to the witnesses, and thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman. Mr. Bachus?

Mr. BACHUS. Thank you, Mr. Chairman. Let me ask the panel this. I get the sense—as members begin to learn about re-insurance and these different issues, it becomes more and more apparent to

me that there is a big distinction between what we are talking about here and the primary market, as far as the State regulators.

State regulators, the justification there is protection of the public. You may have a sophisticated or non-sophisticated party.

With these issues we are dealing with, they are basically a commercial contract between two highly sophisticated commercial entities. I am not sure that I see the justification for the States. Perhaps it is a solvency issue. You would think that these large commercial entities have a lot at stake, and really it is the entity that is going to suffer, not the public.

You are actually having the States intervene in what is a very competitive market. You have the double taxation problems—what is the justification for the States to regulate say coverage or rates in a case of two commercial highly sophisticated enterprises? I think the chairman also alluded to that.

Mr. NUTTER. Mr. Bachus, if I could respond in part, and perhaps Mr. Gates would, as well. In the property casualty re-insurance area, the States do regulate for solvency. They do not regulate for purposes of rates and contract terms.

Because there is no consumer component of a contract between an insurer and a re-insurer, there really is not a reason to regulate in that area. That has worked just fine.

What we unfortunately see is another level of competition, that is the States competing with each other to regulate for solvency. What this legislation would really do is retain solvency regulation, but bring it back to what the NAIC's accreditation system is really all about, that is, having a State of domicile regulate for purposes of solvency as well as the basic transaction.

Mr. BACHUS. You and Mr. Gates both mentioned a global marketplace and the global nature of this whole business. Are there competitive advantages for foreign re-insurers? I would think domestic re-insurers with the 50 State regulatory scheme in place, have a different approach than a foreign re-insurer.

What do they do, letters of credit? How do they function in that market?

Mr. NUTTER. The State system now, of credit for re-insurance, does recognize companies that are licensed in the United States as well as companies that are not licensed. Those companies secure their transactions with security, letters of credit, or funds withheld.

Let me give you a statistic to reinforce the point about the global nature of this business and how it is reflected in this legislation.

Mr. BACHUS. I would think in that regard, it seems to me that a domestic license is being de-valued by this whole environment.

Mr. NUTTER. An excellent point, and that is what the statistic is about. The property casualty re-insurance market has actually been a dynamic area of capital formation since the early 1990's. After Hurricane Andrew—I do not remember the exact number—six to eight new re-insurers were formed with capital in the \$10-to-\$12 billion range.

After the events of 2001, another five or six new re-insurers, new capital, were formed. Again in 2005, another series of new re-insurers were formed. Not one of them was domiciled in the United States—not one of them.

One of the reasons that they do not domicile here is this competitive and cumbersome nature of regulation between the States. When investors can go to a country that has a single regulator for solvency and a single set of rules applicable to the re-insurance transaction, and, pursuant to the State system, provide capacity into the United States. This is to be encouraged.

Your instincts are right, that the current State regulatory system indeed is a deterrent, if you will, to forming a license in the United States. Licensing should be encouraged, in our view.

Mr. BACHUS. I would certainly think that the legislation that Ms. Brown-Waite and Mr. Moore are offering us would at least encourage domestic re-insurance companies to form.

I can also see domiciled overseas, you would avoid the tax environment that you have here, where there is so much uncertainty or double taxation. Is that true?

Mr. NUTTER. I am sure that it is a consideration as companies look at where to domicile, but the companies that do business from overseas are also subject to excise taxes here as well.

Mr. BACHUS. They are not escaping that.

Mr. GATES. If I may, one thing to point out in your comments about the multiplicity of jurisdictions, we are engaged in a circumstance right now where the State of California is in the process of attempting to adopt a very, very expansive view of how it should regulate, regardless of the domicile of a particular insurer or re-insurer, the financial circumstances of any company that happens to have a California license.

Our company has a California license. We have clients who operate in California. Our parent company, because we are foreign owned, provides support to us because of the large amount of money that is involved in the nature of the life re-insurance that we are providing.

The circumstances require me to go to the State of Missouri and get approval of those transactions with an affiliate, and we do that routinely, but under the new California rules, I would have to also get approval from the State of California of those very same transactions that have been passed upon by my domiciliary regulator.

I think everyone understands the difficulty when you try to—when you have two masters, it is very, very difficult to appease them both.

Chairman BAKER. The gentleman yields back. Mr. Kanjorski?

Mr. KANJORSKI. Thank you, Mr. Chairman. There is a provision in the bill that allows the creation of a compact for distribution of revenue. Since the bill goes into effect immediately without the compacts being entered into, the compacts would come after the fact.

As I understand the logic of the bill, the collector would be the State of the corporate entity where they are living. Let's take Wal-Mart. Suddenly, the State of Arkansas would get a tremendous windfall in revenue.

What would incentivize them to enter into a compact to share that with other States?

Mr. BOUHAN. Because there are exposures that Arkansas would have that are from other large national corporations that are domi-

ciled in say New York, Missouri, or California, for which they would get their fair share of the revenue, too.

Mr. KANJORSKI. Their fair share would only be out there if they had some relationship with that transaction. Arkansas only has one company, Wal-Mart. Why would they want to share the proceeds? I'm being facetious, of course.

Mr. BOUHAN. It's reciprocal in that sense is the idea.

Mr. KANJORSKI. There was that famous television program or movie, "Follow the Money." If I were a State that had the obligation or had the right to enter into a compact and I were a net winner in distribution, why would I want to enter into a compact ever with anybody to share the additional proceeds?

Mr. BOUHAN. I understand what you are saying.

Mr. KANJORSKI. Don't we have to work something out there now with the legislation to provide for the distribution of revenue instead of throwing it out there into the ether and allowing compacts to be formed when they may never ultimately be formed?

Mr. BOUHAN. The idea of the compact was to provide a jurisdictional basis to form more or less a clearinghouse so this money could be collected and then distributed based upon a common allocation system.

Mr. KANJORSKI. I understand, but what I am saying to you is if I'm Arkansas, and I am getting 10 to 20 times the revenue, what is my incentive?

Mr. BOUHAN. If they get all the Wal-Mart money, and they get nothing else from any other State, then they are not going to have too much of an incentive.

Mr. KANJORSKI. So, there are going to be winners and losers here.

Mr. BOUHAN. Yes, there will be.

Mr. KANJORSKI. 25 of the States will be losers and 25 of—

Mr. BOUHAN. Right now in the system, it is so opaque, it is so confusing, that there is no certainty or clarity as to what to do.

Mr. KANJORSKI. They may not be distributed correctly now.

Mr. BOUHAN. There are going to be winners and losers, but I do not know if you are going to know who they are necessarily.

Mr. KANJORSKI. It sounds like a great class action, doesn't it?

Mr. BOUHAN. I beg your pardon?

Mr. KANJORSKI. It sounds like a great class action for a lawyer to straighten that out.

Mr. BOUHAN. Yes, it does.

Chairman BAKER. I've got a bill on that, too.

Mr. BOUHAN. Those words—"simplifies tax"—have crossed my ears before.

Mr. KANJORSKI. All I am raising the question on this issue for is there are a lot of compelling reasons why the legislation would accomplish a lot of positive events that I could sympathize with, but in some of these areas, particularly revenue, I think it is something important to pay attention to and get it done now, and have it in the base bill so we do not just allow—I come from the State of Pennsylvania, and we built Interstate 80 across Pennsylvania and had to cross about 70 or 80 miles of New Jersey in order to get to New York.

If my recollection is correct, although it is a little foggy with age now, it took New Jersey about 25 years to close down route 46 because 46 has business properties on it, and they did not want to take the traffic away in order to open up I-80.

There was little incentive to force them to do that. It took a whole generation for them to come on board.

Mr. BOUHAN. We presented the compact idea to the NAIC in the last 2 years, after numerous efforts to try to deal with this issue. Often, when we would talk to the NAIC people about why they weren't willing to get together, why they weren't willing to try to move to solve the problem, the insurance regulators that represent the NAIC would tell us that well, you see, we can deal with insurance matters, but we really cannot deal with tax and revenue matters. This is a whole different set of committees and our legislature. We have to go through the Governor's Office on occasion. They came up with many problems.

We thought maybe if we could come up with the compact idea, that would allow the compact to circumvent just the insurance laws themselves. That was one of the reasons we were trying to present the compact.

Mr. KANJORSKI. I understand that. I have to tell you, if I were a big winner, it would take me an awful lot of time before I would join a compact to take revenue away from my State. I'm just suggesting that I think that is an important issue that we would have to resolve now.

Do you have outlines as to how we could equitably do that distribution? Has someone worked on that particular issue, outside of just giving the authority to create a compact, that we actually create how the structure would work that we could incorporate into the legislation?

Mr. BOUHAN. There was a few years ago a proposal called NITCH, which is non-admitted insurance information tax clearinghouse. It was an electronic clearinghouse idea in which the brokers would submit the information and the taxes and it would be in effect distributed to the various States in that way.

That never really got off the ground too far, but it was a clearinghouse idea. There was some information there and some studies that were done to try to look at how this would be accomplished in that NITCH study. That was about 1996, which I can pull out of my files somewhere and take a look at.

The problem with the NITCH project was at the end of the day, it still never harmonized the laws between the States. It never came up with the standard allocation system. We do not have a standard allocation system now.

If I am a broker in Missouri, and I have exposures in five States, and the five States have different allocation systems, I do not know which allocation system to use. They may be different. In fact, often they are different between the States. Some may be based on square footage. Some base it on revenues of the plant. We do not know which one to use. The whole system is confusing.

Also, the companies submit information to the regulators as to the amount of premium they write in each State. They allocate at the company level the surplus lines premium to the State based upon the exposures in those States.

The brokers have to do it, too. They do it separately. They use different systems because there is no standard system.

Mr. KANJORSKI. Can we establish in the Act the State with the best and most equitable practices and adopt that as the standard?

Mr. BOUHAN. Yes.

Mr. KANJORSKI. Why don't you take the time to analyze which State would be the best? If you remember in the progressive era with the standardization of agricultural products, the 50 States could not agree, and ultimately they agreed to use the Pennsylvania standard. If you were approved by the Pennsylvania Department of Agriculture, you were deemed approved nationwide. It worked very successfully for 100 years.

There has to be one State that has been sophisticated in this that we could perhaps place in the legislation.

Thank you, Mr. Chairman.

Chairman BAKER. Gentlemen, I want to express appreciation to you on behalf of the committee for your participation. It has been very helpful.

As we move forward, we certainly want to continue receipt of your perspectives and recommendations on how we can perfect the pending proposal.

Obviously, there is a critical need. I am just delighted to participate in an insurance hearing where everybody seems to be agreeing. This is a rarity and I am enjoying every minute of it. With that, our meeting stands adjourned.

[Whereupon, at 4:03 p.m., the subcommittee was adjourned.]





# **A P P E N D I X**

June 21, 2006

U.S. Congresswoman

**Ginny Brown-Waite***Representing Citrus, Hernando, Lake, Levy,  
Marion, Pasco, Polk, and Sumter Counties*

**Subcommittee on Capital Markets, Insurance, and GSEs. Hearing  
“Commercial Insurance Modernization”**

June 21, 2006

**Statement for the Record**

Thank you Mr. Chairman for holding this hearing today.

And I want to thank the witnesses for being here today as well.

This Subcommittee has been engaged in overall insurance reform for several years, and in this endeavor, there are dozens of issues the Congress must consider. I have introduced H.R. 5637, the *Nonadmitted and Reinsurance Reform Act* that will provide solutions to two aspects of that reform.

Today, the regulation of the surplus lines market is fragmented and cumbersome. Insurers and brokers who want to provide insurance across state lines are subject to a myriad of different state tax and licensing requirements. For instance, if a company in Florida wants to transport a product, say parts for the space shuttle, to Houston, TX, the non-admitted insurance company they use must comply with the regulations of at least five different states. Often times, these regulations will conflict, making it impossible for one company to comply with all of them. This situation leaves policyholders underinsured and with little choice in providers.

Moreover, most of the policyholders that purchase insurance in the nonadmitted market do so everyday. These “sophisticated” commercial entities have educated risk advisors on staff with a thorough understanding of the market and their risk exposure. Yet in most states, these companies are required to shop around the admitted market and be denied for coverage they know they cannot get before they are permitted to shop in the surplus lines market. This practice is needless and cumbersome, and only adds to the cost for the policyholder.

On another front, in the reinsurance market some state regulators are taking it upon themselves to throw out arbitration agreements between reinsurance providers and

primary carriers. These are contractual agreements decided upon by sophisticated parties on both sides of the transaction to settle disputes without tying up the courts. If these agreements are valid in a state that is accredited by the NAIC, they should be valid in all accredited states.

Accordingly, H.R. 5637:

- Specifies that only the tax policies and licensing regulations of the state in which the policyholder is domiciled govern the transaction. States may still enter into tax allocation and remittance agreements with other states, but this bill specifies which law will take precedence, thus taking the guesswork out of the process. Insurance providers therefore need only comply with those of the policyholders' state in one transaction.
- Requires states within two years of bill passage to participate in the National Association of Insurance Commissioners' national insurance producer database and adopt regulations under NAIC's Nonadmitted Insurance Model Act.
- Allows sophisticated commercial entities direct access to the surplus lines market.
- Prohibits states from voiding established, contractual arbitration agreements between reinsurers and primary companies.

Obtaining insurance for unique or high-risk products in the nonadmitted market already has its own obstacles. Adding a quagmire of inefficient state rules does not help. And with reinsurance rates rising at an alarming rate, companies should be encouraged to stay out of the courts and follow their own arbitration agreements.

My bill provides commonsense solutions to the nonadmitted and reinsurance market, and I thank the Chairman for holding this hearing on it today.

**OPENING STATEMENT OF  
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI  
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,  
AND GOVERNMENT SPONSORED ENTERPRISES  
HEARING ON COMMERCIAL INSURANCE MODERNIZATION  
WEDNESDAY, JUNE 21, 2006**

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Mr. Chairman, we return this afternoon to a topic that we have often discussed in recent years: the need for insurance regulatory reform. This time we will focus on the issue of commercial insurance modernization.

As I have previously said, no matter what side one takes in this long-standing debate on regulatory efficiency, it has become increasingly clear to me that this is no longer a question of whether or not we should reform insurance regulation in the United States. Instead, it has become a question of how we should reform insurance regulation.

As you know, Mr. Chairman, we have begun to develop a growing consensus in Congress about the need to improve insurance regulation. During our previous hearings on insurance reform, we have also received extensive testimony from many witnesses advocating the creation of an optional federal charter, a proposal that I believe merits our attention.

Furthermore, since our last hearing on insurance regulation some of our colleagues in the Senate have introduced S. 2509, the National Insurance Act, to create an optional federal charter. Rather than overlaying federal mandates on top of state regulation, an optional federal charter would, in my view, create a sensible, separate, and streamlined regulatory system. In the future, Mr. Chairman, I hope that we will take the time to convene hearings on and study the implications of their proposal.

Nevertheless, the focus of today's proceedings is H.R. 5637, the Nonadmitted and Reinsurance Reform Act. Many sophisticated participants in our insurance markets have complained about problems in the regulation of surplus lines and reinsurance. H.R. 5637 seeks to address these concerns.

Large commercial entities, major insurers, and reinsurance companies all operate across state lines. They both want and need greater regulatory efficiencies. As I have learned more about these concerns about licensing, invoicing, and documenting, I too have become increasingly sympathetic about the need to address them.

Before moving forward with the consideration of this bill, however, we need to hear from the National Association of Insurance Commissioners. Last year in testimony before our panel, the NAIC's president noted that federal legislation "may be needed at some point to resolve conflicting state laws regulating multi-state transactions" involving surplus lines. She also observed that federal legislation was "not needed" in the area of reinsurance.

The development of good public policy requires the input of all interested parties and constituencies. In this case, the NAIC is one very interested party. Even if we ultimately decide to disagree, we need to engage with them in a constructive dialogue.

(more)

While H.R. 5637 is well intentioned, I am also somewhat concerned that proceeding with piecemeal reform legislation like this bill could hamper future efforts to adopt more comprehensive proposals like an optional federal charter. In the area of health insurance, the many federal mandates that we have imposed have made it more difficult to develop a national consensus on far-reaching reforms. We should not repeat that mistake here. Nonetheless, I also recognize that we should not allow the proverbial perfect to be the enemy of the good.

In addition, I am concerned that this legislation does little to establish a federal expertise in the area of insurance. At times, this lack of expertise has caused difficulties for us. For example, although many Members of Congress had concerns about the insurance industry's ability to respond to the 2001 terrorist attacks, they had difficulty in immediately identifying federal experts to advise them in these matters.

The deficiency of federal knowledge about the insurance industry might have also impeded our efforts to adopt expeditiously the terrorism reinsurance backstop law. As a result, we might want to consider how we could improve H.R. 5637 to enhance the federal government's understanding of the business of insurance.

In closing, Mr. Chairman, I commend you for continuing to focus our committee on the issue of insurance regulation. These are important discussions for us to have and important matters for us to resolve.

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**National Association of Professional Surplus Lines Offices, Ltd.**

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Richard M. Bouhan  
Executive Director

**TESTIMONY OF THE NATIONAL ASSOCIATION OF PROFESSIONAL SURPLUS  
LINES OFFICES BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE,  
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT  
SPONSORED ENTERPRISES REGARDING H.R.\_\_\_\_\_, THE  
NON-ADMITTED AND REINSURANCE REFORM ACT OF 2006**

**June 21, 2006**

Chairman [Richard] Baker, Ranking Member [Paul] Kanjorski, and Members of the Subcommittee, my name is Richard [Dick] Bouhan and I am the Executive Director and General Counsel of the National Association of Professional Surplus Lines Offices -- NAPSLO -- and I am pleased to be here before you today to offer testimony on H.R.\_\_\_\_\_, the Non-Admitted and Reinsurance Reform Act of 2006.

NAPSLO is a national trade association representing the surplus lines industry and the wholesale insurance marketing system. NAPSLO is the only association to represent both surplus line companies and brokers. Founded in 1974, NAPSLO has concentrated on being a trusted voice on surplus lines issues in all 50 states, as well as in Washington, DC. NAPSLO is a valuable source of information regarding the vital role surplus lines plays in the insurance industry. NAPSLO has over 800 members representing 15,000-20,000 individual brokers, agents, company professionals, underwriters and other insurance professionals in all fifty states and the District of Columbia.

NAPSLO commends the Subcommittee and the leadership of Chairman Richard Baker for taking surplus lines and reinsurance concepts from the original Subcommittee draft of the State Modernization and Regulatory Transparency Act (SMART Act) proposal in an effort to speed the advancement of these concepts through the legislative process. We also appreciate and thank

Representatives Ginny Brown-Waite and Dennis Moore for their foresight in introducing this significant legislation that recognizes the need for pragmatic reform and modernization of the surplus lines and reinsurance markets. This initiative will bring long overdue modernization to regulation of these important segments of the insurance market while at the same time underscoring the need for comprehensive insurance modernization by placing these particular lines of insurance at the forefront of the Subcommittee's insurance reform agenda.

Surplus lines is property and casualty insurance that covers unique, unusual, hard-to-place or non-standard risks for which insurance is not typically offered by insurers operating in the licensed or "admitted" or standard marketplace. Often referred to as "non-admitted" insurance, surplus lines covers risks that state-licensed or "admitted" companies are unable to or will not insure or do not meet the insurance requirements of the buyer.

The need for an insurance buyer to access the surplus lines insurance market can stem from an inability of standard or admitted companies to effectively evaluate a particular risk because of the risk's unique, novel or difficult underwriting characteristics or because of the lack of sufficient statistical information about the risk or that class of risk that would allow standard company underwriters to sufficiently analyze it. The need for surplus lines treatment may also evolve from the fact that a buyer may desire a level or limits of coverage on a risk that exceed that which standard or admitted companies are willing or able to offer.

State legislatures have recognized that these exigencies frequently exist in licensed insurance markets and have provided a statutory framework to allow insurance buyers regulated access to non-licensed or "non-admitted" surplus lines companies, through specially licensed brokers, in order to provide them coverage through the surplus lines market when buyers are unable to secure

the coverage from the admitted or licensed market in their particular state<sup>1</sup>. Thus, every state has created a supplemental property/casualty market of eligible surplus lines insurers whose unlicensed or non-admitted status gives them the capability and flexibility to respond to a buyer's specific needs and to the buyer's coverage problems.

Surplus lines coverage frequently involves specialty risks for commercial clients. Some of the risks insured in the surplus lines market include kidnapping and ransom coverage, business interruption, environmental impairment, special events, "hole-in-one" or prize indemnification coverage, amusement park rides, and coastal properties, as well as general, professional and business liability coverage for those risks with unique, difficult or "challenging" underwriting characteristics are all insured in the surplus lines market. The surplus lines market also insures more common or recognizable types of risks that become difficult for the standard market to insure as a result of a volatile and changing legal environment. For example, in the wake of a massive escalation in construction defect lawsuits, in recent years, residential building contractors have relied heavily on the surplus lines market to craft industry specific policies. In the 1980's, day care centers looked to the surplus lines market for coverage. Also, businesses, particularly small businesses that have pollution exposures are found insured in the surplus lines market

The surplus lines market has been and continues to be the incubator for new coverages. Asbestos abatement coverage was first developed and offered in the surplus lines market. The umbrella coverage contract was first created and sold in the surplus lines market. Employment Practices Liability Insurance (EPLI) was nurtured in the surplus lines market. A number of e-commerce and computer software liability coverages are being "tested" in the surplus lines market. It is the freedom of rate and form that surplus lines companies exercise as a result of their unlicensed or

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<sup>1</sup> Surplus lines companies and producers must be licensed in their home state or country in order to operate as a non-admitted insurer in other jurisdictions.



non-admitted status that allows them the flexibility to develop new coverages and write difficult to place, unique and high limit risks.

Often, after a new coverage has proven itself in the surplus lines market and sufficient loss data has been established to provide a statistical basis to form credible rates, the coverage becomes a standard product in the admitted or licensed market.

Thirty-five billion dollars in annual premiums are written by surplus lines carriers. This figure represents over 13% of the total annual amount of commercial property/casualty insurance premium.

The surplus lines transaction is regulated, by the states, through the licensed surplus lines broker who assumes special responsibilities to both the state and to the insured. Although not the regulated entities in a surplus lines transaction, the nonadmitted or unlicensed surplus lines insurers that form the surplus lines market in a state must meet specific capitalization, financial and other standards, established by the state, in order to be eligible to do business with licensed surplus lines brokers. In addition, in a surplus lines transaction, it is the licensed surplus lines broker who is responsible for regulatory compliance and it is the surplus lines broker who is solely responsible for remitting the surplus lines premium tax to the state tax collection agencies.

Unfortunately, the current system of state regulation of surplus lines lacks clarity and is fraught with confusion and inconsistencies.

H.R. \_\_\_\_\_ provides relief to the regulatory breakdowns in the non-admitted marketplace that are causing disruptions to the market and the bill takes the appropriate steps to correct them. These problems bring an undue burden on the licensed insurance professionals providing access to this market and the commercial insurance consumers they endeavor to serve.

As noted previously, chief among NAPSLO's concerns is the inconsistent way in which states manage their premium tax allocation and remittance schedules. This problem only exacerbates the mounting confusion experienced by surplus lines producers. The proper allocation and remittance of surplus lines premium taxes to the states on multi-state risks has been a growing problem for decades.

The passage of the Gramm-Leach-Bliley Act in 1999 added to the severity of this burden by increasing the number of non-resident surplus lines broker licenses. GLBA "compelled" states to grant reciprocal licenses through a threat of preemption, and, as more surplus lines brokers obtained nonresident surplus lines licenses, they quickly discovered that state laws fail to provide guidance on which state surplus lines law governs a multi-state surplus transaction.

The failure of the states to establish a uniform and consistent method of remitting surplus lines premium taxes on multi-state surplus lines risks has brought forth confusion and complexity in the market from the standpoint of the consumers as well as the producers.

Industry efforts, over the past two decades, to work with the National Association of Insurance Commissioners (NAIC) to solve the surplus lines premium tax allocation and remittance problems through initiatives to harmonize the inconsistencies have all proved unsuccessful. Over time, however, the severity of this problem has increased, since more and more surplus lines placements have become multi-state risks. The genesis of this problem lies in the contradictory and inconsistent state regulatory and tax laws, which make multi-state surplus lines transactions complicated, confusing, and very costly to all parties.

The inconsistencies and conflicts associated with this problem can be narrowed down to two primary areas. First, there is no universally accepted allocation formula among states: meaning the

broker must determine which state's allocation formula governs the transaction in a multi-state transaction. Second, the taxing provision of each state's surplus lines laws are directed to the broker placing the coverage, requiring that any tax on the portion of the premium allocated to the state be paid to that state. There is no mandate in state laws that the broker remit a tax on portions of the premium allocated to other states. Therefore, there is no true legal authority requiring the broker to remit the premium tax to another state, particularly to a state in which the broker is not licensed.

NAPSLO is pleased that the Committee recognizes that the systemic problems associated with premium tax allocation and remittance have created stumbling blocks in the surplus lines marketplace, and that a common-sense legislative solution has been incorporated into this bill. This legislation establishes a uniform system of premium tax allocation and remittance, creating a system of home state deference for non-admitted insurance; prohibits any other state than the home state of the insured from requiring any premium tax payment for non-admitted insurance; and, authorizes states to enter into a compact as a means of harmonizing allocation and remittance standards. NAPSLO has publicly endorsed the merits of this approach in the past and we are encouraged that this important concept has been included in the underlying bill. A legislative approach requiring adoption of an interstate compact, which is a treaty agreement among those states that adopt it, could succeed with broad industry support. A compact will greatly simplify the formulas used for tax allocation without undermining the authority of the states.

The second regulatory breakdown that NAPSLO has identified is that of licensing standards. The current system has no true safeguards to prevent licensing discrimination against nonresident agents and brokers, and the lack of clarity has created a varying regulatory climate which changes, for better or for worse, according to the jurisdiction in which you operate. This bill addresses this

problem by adopting uniform standards for producer licenses. This provision mandates that no jurisdiction other than an insured's home state may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate non-admitted insurance. This provision has federal preemptive authority over noncompliant states as a means of maintaining a strong enforcement mechanism. NAPSLO also endorses the concept of a national producer database established in the bill, which will assist with the proper collection of licensing fees for non-admitted brokers.

Multiple compliance requirements for surplus lines brokers are fraught with bureaucratic red tape, and NAPSLO has long been a proponent of reciprocal participation across jurisdictions. To illustrate my point, consider a broker who has exposures in 5 different states; does this constitute the application of 5 separate state laws and 5 different tax filings? Does this require 5 diligent searches and 5 different license requirements? Now imagine how this problem would translate nationwide with an exposure in 50 states. This is nothing short of a recipe for disaster, and further demonstrates why the harmonization of varying state laws is sound public policy and the right approach for all stakeholders operating in the non-admitted market.

Finally, NAPSLO is encouraged by the Committee's determination that access to the non-admitted marketplace should be streamlined for sophisticated commercial purchasers. A sophisticated buyer of insurance is, by the standards and definition outlined in the bill, operating at a level that typically exceeds the risk management capabilities provided on the admitted marketplace. While NAPSLO can identify with the important role due diligence plays in assuring there are proper checks and balance between the placement of risk in both the admitted and non-admitted market, sophisticated purchasers are at such a high buying level, forgoing a search for admitted coverage simply eliminates an unnecessary step in the placement process, particularly in states where the commercial market is deregulated. Furthermore, the bill goes so far as to establish safeguards and

disclosure requirements that fully apprise the sophisticated purchaser that their streamlined access to the surplus lines market may or may not inhibit their ability to obtain coverage on the admitted market. NAPSLO commends the Committee for their recognition that many state requirements are burdensome, and involve an unnecessary layer of regulatory oversight for consumers and brokers that do not apply to the admitted market.

This legislation is the right policy at the right time. It provides regulatory relief for a technical and often misunderstood insurance market that is subject to a broad array of unnecessary regulatory requirements of varying degrees. This bill does not undermine the consumers' ability to make informed purchasing decisions, nor does it circumvent any state department of insurance's ability to police the surplus lines activity within their jurisdiction. It does, however, endeavor to create parity and balance for the surplus lines industry at a time when it is needed the most. NAPSLO again commends Chairman Baker for his leadership and for holding this hearing and thanks Representatives Ginny Brown-Waite and Dennis Moore for introducing this important piece of legislation. NAPSLO looks forward to working with the subcommittee, the full Committee as well as with the entire House of Representatives to try and help this important bill move through the legislative process. Thank you for your time and attention to these complex but crucial segments of the insurance industry. I would be pleased to answer any questions you may have.

**RICHARD M. BOUHAN**  
Executive Director

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Richard M. Bouhan is Executive Director and General Counsel to the National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO). He has held this position since December 1987. Previously, Mr. Bouhan was NAPSLO's Director of Government and Industry Affairs and Counsel. As Executive Director, Mr. Bouhan is responsible for directing all staff functions and for the overall conduct of the Association's staff activities. He is also directly responsible for the conduct of NAPSLO's legislative programs and serves as legal counsel to the Association.

As Executive Director and General Counsel for NAPSLO, Mr. Bouhan teaches a surplus lines course, every year, at the Association's Excess & Surplus Lines School and the Advanced Excess & Surplus Lines School. The NAIC, in conjunction with NAPSLO, coordinates the NAIC/NAPSLO School for Regulators bi-yearly where he teaches course on insurance regulation. Throughout the year, he speaks on the subject of surplus lines at various industry meetings. Also, on a yearly basis, Mr. Bouhan does a presentation on surplus lines regulation at the Risk Takers Symposium (sponsored by Olivet College and the Derek Hughes/NAPSLO Educational Foundation) and at the Troy University Symposium (sponsored by Troy University and the Derek Hughes/NAPSLO Educational Foundation).

Prior to joining NAPSLO in 1981, Mr. Bouhan served as Associate Counsel for the National Association of Independent Insurers (NAII) and as Assistant Director of the Legislative Service Division of the Blue Shield Association (BSA). Mr. Bouhan was also a commissioned officer of the United States Health Service serving as Chief of the Office of Program Planning and Evaluation for the Navajo Indian Reservation area office.

A graduate of Johns Hopkins University, Mr. Bouhan received his Juris Doctorate degree from Loyola University of Chicago School of Law and a Master in Law in Taxation degree from DePaul University College of Law. He also holds a Master in Government Administration degree from the Wharton School of the University of Pennsylvania, where he was a Samuel S. Fels Fellow and Scholar.

Mr. Bouhan is a member of the Illinois, Georgia, Florida, Missouri and Kansas bars, and is admitted to practice before the United States Supreme Court. He is a member of the American Society of Association Executives, and a member of the American Bar Association and a member of that association's Sections on Torts and Insurance Practice and Administrative Law and Regulatory Practice.

The following is list of articles that Mr. Bouhan has written.

"A Dangerous Confusion"  
*Best's Review*  
August 1992

"Surplus Lines: Its History, Structure and Current Issues"  
August 1994

"Surplus Lines: Its History, Structure and Evolution"  
February 1995

"Surplus Lines Taxes"  
Florida Surplus Lines Association  
April 1997

**Bio—Richard M. Bouhan**  
**Page Two**

"Cyberians at the Gate?"

*The Brief*

(Published by the American Bar Association)

Spring 1998

"Solving the Multi-State Taxation Problem"

*National Underwriter*

August 1999

"Solutions Needed for Surplus Lines Industry Multi-State Tax Woes"

*National Underwriter*

October 1999

"Gramm-Leach-Bliley: A New License for Surplus Lines"

*Financial Service Modernization: The Impact of the Gramm-Leach-Bliley Act*

(Published by the CPCU Society)

2000

"Background Paper on Surplus Lines Taxation"

March 2000

"Changing the Surplus Lines Landscape: Gramm-Leach-Bliley"

*National Underwriter*

August 2000

"Surplus Lines Broker Bonds—An Opportunity for Repeal"

*Florida Underwriter*

August 2002

"Chapter 2: Insurance Regulation"

*Surplus Lines Insurance Principles and Issues (Feldhaus Edition)*

(Published by the AICPCU)

1995

"Chapter 3: Regulation of Surplus Lines Insurance"

*Surplus Lines Insurance Principles and Issues (Feldhaus Edition)*

(Published by the AICPCU)

1995

"The Future is Now: Regulation of the Surplus Lines Industry After Gramm-Leach-Bliley"

February 2004

"Independent Procurement"

*TIPS*

(Published by the American Bar Association)

August 2004

"Insurance Regulatory Reform: An Old Son with Some New Refrains"

*The Baker Chair Journal of Insurance, Risk and Public Risk Management*

Southwest Missouri State University

Spring 2005



**Statement  
of the  
American Council of Life Insurers  
on  
HR 5637  
The Nonadmitted and Reinsurance Reform Act of 2006  
before the  
Subcommittee on Capital Markets, Insurance and  
Government Sponsored Enterprises  
of the  
House Financial Services Committee  
of the  
United States Congress  
June 21, 2006**



Mr. Chairman and members of the Subcommittee, I am David A. Gates, Senior Vice President, General Counsel and Secretary of Generali USA Life Reassurance Company (Generali USA), based in Kansas City, Missouri. My professional background includes serving as Insurance Commissioner of Nevada from 1984 to 1990 and on the Executive Committee of the National Association of Insurance Commissioners (NAIC) from 1986 to 1990. I was President of the NAIC in 1989. This background, together with my experience as an officer of a U.S. professional life reinsurer, gives me a bit of insight into the issue that this Subcommittee is addressing today.

As I understand it, we are here today to discuss the need for regulatory certainty and a level regulatory playing field. We support both. Life reinsurance is and always has been a fundamental underpinning of the life insurance industry and an international business. In order to strike a balance between solvency protection and access to capital and a competitive marketplace, life insurers must have modern, best-practices supervision by a single regulator.

My company began as a health insurer known as Business Men's Assurance Company and first sold life insurance in 1920. It first sold life reinsurance in 1928 and formally established its life reinsurance division in 1948. It was acquired by the Generali Group in 1990. Today my company is a wholly owned subsidiary of Assicurazioni Generali S.p.A. (Generali), a leading international insurer based in Trieste, Italy. Generali was established in 1831 and has grown to a conglomerate of 226 insurance and financial services companies worldwide. It is the leading life insurance group in Italy by market share and one of the largest insurance groups in Europe by market capitalization. Today Generali USA sells only life reinsurance and is recognized as one of our industry's top professional life reinsurers.

I am here today on behalf of the American Council of Life Insurers (ACLI). ACLI is the principal U.S. trade association for life insurers. ACLI's 377 members account for 91 percent of the industry's total U.S. assets. ACLI members offer

life insurance, annuities, pensions (including 401(k)s), long-term care insurance, disability income insurance, reinsurance, and other retirement and financial protection products.

I appreciate the opportunity to appear this afternoon and present the views of the purchasers and sellers of life reinsurance on modernizing reinsurance regulation. As you know, modernizing insurance regulation continues to be an overarching priority for the entire life insurance industry. Our objective is a more efficient state-based system of regulation coupled with a comprehensive federal regulatory option, and we will continue to work with the Subcommittee on modernizing insurance regulation.

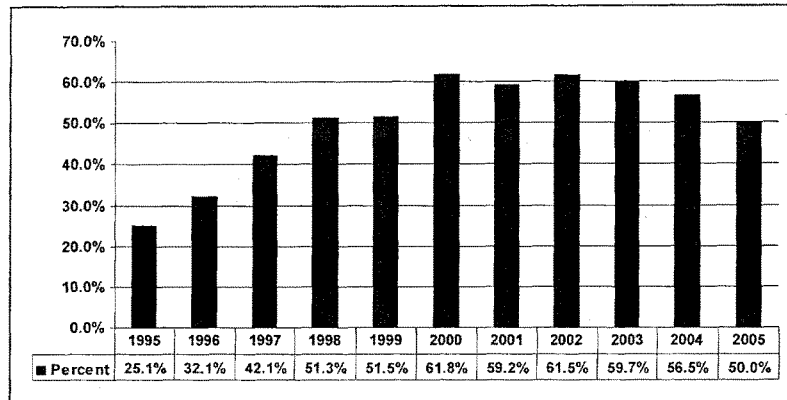
#### Life Reinsurance Is Commercial Insurance for Life Insurers

We agree with the premise of this hearing and the legislation—that U.S. supervision of reinsurance needs reform. Life reinsurance is insurance for life insurers, a business-to-business commercial transaction. Just as consumers purchase life insurance and annuities to protect themselves against risk, life insurers buy reinsurance to protect themselves against the risks inherent in life and health insurance policies and annuity contracts they sell to consumers. Those risks can be mortality and morbidity risks, investment risks, cash-flow risks, and other related risks. Regardless of reinsurance, life insurers remain directly obligated to consumers for the benefits of their life insurance policies and annuity contracts. Life reinsurance is an indemnity contract between a purchasing life insurer and a reinsurer, which is freely negotiated between those sophisticated commercial parties.

Life reinsurance has become increasingly important to life insurers (see illustration). It is a fundamental risk management tool and a source of capital and product innovation support for life insurers. Today, U.S. life insurers cede about

half of all their risks to life reinsurers, on average. The total amount of life reinsurance in force as of year-end 2005 was U.S. \$5.87 trillion.

Trends in Life Insurance—Percent Reinsured



Source: Society of Actuaries and ACLI

#### U.S. Regulation of Life Reinsurance Needs Improvement and Certainty

We recognize and appreciate the many experienced and dedicated insurance regulators currently serving the public, our industry, and our policyholders. We believe, however, that increasingly they are laboring under a system that is incapable of responding adequately to the realities of global risk and capital management. My comments, to the extent they may be interpreted as criticisms, are directed at the system itself and certainly not at the individuals charged with administering it.

We have concerns about the current 50-state system of regulating life reinsurance. U.S. regulation of life reinsurance has become increasingly ad hoc and inconsistent. It has not kept pace with the risk-based regulatory standards of competing financial sectors, such as banking. It has not recognized newer forms of reinsurance as prudent risk management tools for life insurers in their

development of consumer-driven financial and retirement security products. In short, the current 50-state system of regulating life reinsurance has not adapted to current best-practices standards of financial supervision.

Regulatory improvement is needed. Life reinsurance agreements diversify risks that life insurers undertake in providing financial security for consumers. Simple economic proves that a wide diversification of life insurer risks lowers the ultimate costs to consumers. Insurance supervision should support responsible risk diversification.

Current U.S. regulation of life reinsurance impedes insurer risk diversification. It discourages innovation and encourages life insurers to buy one-size-fits-all reinsurance. A life insurer may purchase a different “size” of life reinsurance, but current U.S. regulation may recognize that reinsurance in one state but not another, thereby limiting life insurers’ ability to manage risk competitively and effectively. The following example proves the point:

In New York, a life insurer can receive approval for counting reinsurance of certain high risk benefits in life insurance policies and yet be unable to count that reinsurance in its financial reports to California because California will not recognize it.

ACLI has repeatedly pressed state insurance regulators to modernize and unify life reinsurance regulation. In spite of substantial support, there has been no reform. We believe that this failure is due largely to the refusal by states to rely on each others’ assessment of their domestic insurers’ financial condition. The current system of overlapping and inconsistent reinsurance regulation—where states are permitted to second guess fellow states’—must be reformed in order to ensure a vibrant and competitive life insurance market for U.S. consumers.


Regulatory certainty is needed. Life reinsurance has been strictly and heavily regulated in the U.S. since 1985. In theory, the home state of a life insurer is responsible for regulating its reinsurance purchases based on standards set by the NAIC. In practice, however, many states apply their laws on reinsurance outside their borders. Sometimes the laws themselves are different and sometimes the regulations are different. More often, similar laws or regulations are interpreted differently—not infrequently through informal application of unwritten insurance department practices. There are many examples of the redundancies and inconsistencies that this overlapping and inconsistent regulation creates, but this one proves the point:

A letter of credit acceptable to the New York Insurance Department is not acceptable to the California Insurance Department, and vice versa.

Such archaic constraints are unrelated to sound principles-based supervision and provide no regulatory or consumer benefit. Instead, they balkanize capital, increase its cost, and depress insurance and reinsurance capacity. We believe these constraints exist because in a 50-state system no single regulator is charged with balancing regulatory prudence with a vibrant marketplace.

#### Summary

We support and encourage the dialogue that this bill promotes. We appreciate the time and effort that this Subcommittee, its members and staff have invested in understanding our industry and its current regulation. We believe strongly that U.S. reinsurance regulation must be modernized and hope we have demonstrated that necessity. Inasmuch as this bill establishes a more efficient state-based system of regulating an important aspect of life insurer operations, we endorse it. At the same time, we urge the Congress to pursue a comprehensive federal regulatory option for insurers and reinsurers.

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TESTIMONY OF  
BERND G. HEINZE, ESQ.  
EXECUTIVE DIRECTOR OF THE  
AMERICAN ASSOCIATION OF MANAGING GENERAL AGENTS  
  
BEFORE THE  
  
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE  
AND GOVERNMENT SPONSORED ENTERPRISES  
OF THE U.S. HOUSE OF REPRESENTATIVES  
COMMITTEE ON FINANCIAL SERVICES  
  
ON  
  
COMMERCIAL INSURANCE MODERNIZATION AND  
THE NONADMITTED AND REINSURANCE REFORM ACT OF 2006

**Introduction**

Good afternoon Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee. My name is Bernd G. Heinze. I am the Executive Director of the American Association of Managing General Agents (AAMGA), headquartered in King of Prussia, Pennsylvania, just west of Philadelphia.

The AAMGA is an international trade association comprised of 503 member agents, brokers, insurance, captive and reinsurance companies, Lloyd's of London syndicates and underwriters, state stamping and surplus line offices and related professional entities all engaged in the wholesale insurance marketplace in the United States and the United Kingdom. Since 1926 AAMGA members have been committed to serving the non-admitted or excess and surplus lines and admitted markets, with reliable integrity, and in offering creative, dependable insurance products, services and solutions to specialty and unique risk exposures. Collectively, these efforts identify the Association as the professional standard to the wholesale insurance market, and as a credible authority to matters of importance to the global insurance community.

*A Heritage of Integrity and Professionalism*

Testimony of Bernd G. Heinze, Esq.  
 American Association of Managing General Agents  
 June 21, 2006  
Page Two

The AAMGA's 262 member managing general agents are located in all 50 states and are called upon to work with retail agents and their policyholder customers in all lines of insurance business. In 2004, they wrote in excess of \$23.9 billion in annual written premium, or approximately 72% of the gross excess and surplus lines premium written in the non-admitted market. Our member agents employ over 10,000 employees in over 350 storefronts across America.

Thus, we see each day the challenges and opportunities that exist in this market, and are honored to have the privilege to share our views in support of the Committee's on-going efforts. We have reviewed the "Non-admitted and Reinsurance Reform Act of 2006" and today provide comment in support of its provisions generally, while also offering to provide supplemental remarks on items for further consideration. The AAMGA commends you Mr. Chairman, and this Committee, on the continuing focus to modernize commercial insurance markets and, thereby, implement procedures and regulations that will enhance uniformity and competition, while maintaining the state based system of insurance regulation and the surplus lines market's fundamental precept of freedom from rate and form to benefit the consumer in the protection of its risk exposures.

#### **Overview into the Excess & Surplus Lines Insurance Market**

All states and jurisdictions have promulgated surplus lines laws to protect the insurance consumer by controlling eligibility standards of surplus lines insurers and requiring specialty licensed brokers and agents to assist the consumer. These standards facilitate the open market, enhance competition, allow agents, brokers and insurers to be more responsive to consumer needs and provide the flexibility in the buying decisions being made.

The surplus lines market is essential to our nation's economic infrastructure. It provides protection and security to national industrial and local commercial businesses, those associated with operation of major public facilities like airports, schools, municipal utilities, and some of the largest port facilities in the country.

In the private sector, key commercial enterprises and consumers similarly rely on the surplus lines marketplace. These risks include, for example, those associated with electrical generation, oil production and refining, heavy construction, private aviation, ski resorts, trucking companies, restaurants and small businesses, aerospace manufacturing, mining, and agriculture, nursing homes and day care centers, large and small commercial and residential construction projects; maritime risks from jet skis to tanker vessels and every day risks from Main Street to Wall Street.

*A Heritage of Integrity and Professionalism*

Testimony of Bernd G. Heinze, Esq.  
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 June 21, 2006  
Page Three

AAMGA managing general agent members include professional insurance facilities of varying size and multi-state operations to small and family businesses vital to maintaining the spirit of entrepreneurial growth in the insurance industry and our economy.

#### **Current Issues Impacting the Non-admitted Market**

While the premium growth of the surplus lines market now comprises 14.14% of the gross written property and casualty premium in the United States, our managing general agent, broker and company members, as well as their customers and consumers, face increasing processing and compliance costs due to inefficiencies and inconsistent standards now existing in the various states. For example, depending on rules of a home state and the nature of a multi-state risk, volumes of affidavits confirming the completion of a diligent search, the completion and filing of state tax payment forms and related materials are necessary to adhere to individual state requirements.

Further, for multi-state managing general agents, brokers and insurance companies, the various state licensing, continuing education requirements and non-reciprocal state regulations place added burdens and unnecessary costs on to the insurance transaction, without a commensurate increase in value to the consumer.

#### **Benefits of the Non-admitted and Reinsurance Reform Act of 2006**

Insurance is the DNA of capitalism and free market entrepreneurship. Providing the availability of varying levels of security from risk stimulates the growth of business and opportunities, provides incentives for research and development that help to create jobs and positive returns on investment and equity; and, for the public and private consumer, affords continuity and recovery from fortuitous events based on the terms and conditions of coverage.

For all these reasons, the AAMGA supports the Non-admitted and Reinsurance Reform Act of 2006, and appreciates the efforts of Ms. Brown-Waite and the co-sponsors of the Bill in utilizing this opportunity to focus on the need for insurance regulatory reform. The AAMGA's independent insurance adjuster members also strongly support reform efforts to break down antiquated state-by-state barriers. Through their work with non-admitted insurers, reinsurers, and other industry partners, independent adjusters know all too well that needlessly restricting insurance services across state lines is inefficient and, ultimately, unsustainable.

Specifically, we believe the Bill and this Committee's other efforts on commercial insurance modernization will:

*A Heritage of Integrity and Professionalism*



Testimony of Bernd G. Heinze, Esq.  
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- enhance the speed to market of new and needed insurance products and services;
- stimulate open competition and the creation of innovative risk products specifically addressing or manuscripted to the needs of the consumer;
- establish and mandate a uniform, simple tax allocation formula and system for multi-state risks, making the payment of proportionate tax more equitable and efficient;
- allow for automatic export for exempt commercial purchasers – the sophisticated insurance buyers as defined in the Act – without the burdensome diligent search requirements, thus allowing the surplus lines marketplace to work more efficiently and specifically to the needs of the consumer, insurance companies, wholesale and retail agents and brokers;
- facilitate uniform and consistent compliance requirements for the surplus lines agents and brokers now that the insured's home state will have authority and regulatory primacy;
- encourage individual initiatives toward sustained growth to protect increased risk exposures;
- establish a uniform and consistent licensing system created by the national insurance producer database; and
- allow a more equitable and efficient framework within which an insurance purchaser can work with their agent or broker of choice, without being forced to engage in time consuming and wasteful transactions in an inefficient network borne solely by the perceived need of multi-state compliance.

#### Conclusion

Mr. Chairman, this Act is an important step in sustaining the non-admitted insurance market's effective, efficient and economical services to the public and private sector, while streamlining the processing, licensing and compliance components of insurance transactions. Most importantly, it will develop and create a uniform and consistent foundation on which essential state based regulation can continue without restraining the creativity, investment and security provided by the surplus lines market.

The AAMGA looks forward to working with you Mr. Chairman, Ms. Brown-Waite, Ranking Member Kanjorski, and our other Pennsylvania representatives on the Committee, Mr. Fitzpatrick and Mr. Gerlach, Members of the Committee and co-sponsors of the Non-admitted and Reinsurance Reform Act of 2006, in furthering to develop the specifics and implementation of commercial insurance reform and modernization.

Thank you for the opportunity to provide the views of the American Association of Managing General Agents. We look forward to responding to any questions you may have, and providing additional information.

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**Bernd G. Heinze, Esquire**  
**Biographical Summary**

Bernd G. Heinze, Esquire is executive director of the American Association of Managing General Agents (AAMGA), representing the 503 premier companies involved in the international wholesale insurance distribution marketplace, and its University. He is certified by all 50 state insurance departments to provide continuing education courses on insurance and litigation matters, and is regularly called upon to render expert witness testimony in state and federal courts.

Mr. Heinze has served as Vice-President and Chief Litigation Counsel for the Reliance Insurance Company in Philadelphia, where he was responsible for the management of all property and casualty litigation nationwide, outside panel and 12 staff counsel operations of the company, and its environmental and mass tort, compliance and bad faith units, with an over \$120 million annual budget.

Prior thereto, Mr. Heinze was an equity partner with the Wilson, Elser, Moskowitz, Edelman & Dicker law firm, where his practice was concentrated in the resolution of insurance related litigation, including professional errors and omissions, third-party products, fire, wrongful death, municipal and employment liability, commercial automobile, medical malpractice, social services, construction defect, advertising injury, asbestos, toxic/mass tort, class action, transportation, and bad faith claims, ADR/arbitration matters, subrogation and declaratory judgment/coverage actions.

Mr. Heinze graduated with a BA in International Relations and Economics from the Canisius College (1978) in Buffalo, NY, and obtained his Juris Doctor degree with honors from the Temple University School of Law (1983) in Philadelphia where he was editor in chief of the law school magazine. He is licensed to practice before the United States and Pennsylvania Supreme Courts, and the federal courts of Pennsylvania.

Prior to his legal practice, he was a Congressional Assistant to Congressman Jack Kemp in the Washington, DC and Buffalo, NY offices, and executive assistant and deputy press secretary to Erie County (NY) Executive Edward J. Rutkowski. He also worked as weekend anchor for WAVA NewsRadio in Washington, DC.

Mr. Heinze serves on the Board of Directors of the International Litigation Management Association and the American Association of Independent Claim Professionals. He has been named as one of the "100 Most Powerful People in the Insurance Industry – North America" since 2001 by the *Insurance Letter* and *Insurance Distribution Magazine*.

Living in Montgomery Township, PA with his wife and two daughters, Mr. Heinze began and serves as president and an active firefighter with the Fire Department of Montgomery Township, and a member of the Industrial Development Authority.



*Independent Insurance Agents  
& Brokers of America, Inc.*

**STATEMENT OF TOM MINKLER  
ON BEHALF OF THE  
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA**

**BEFORE THE**

**SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND  
GOVERNMENT SPONSORED ENTERPRISES**

**COMMITTEE ON FINANCIAL SERVICES**

**UNITED STATES HOUSE OF REPRESENTATIVES**

**June 21, 2006**

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Good morning, Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee. My name is Tom Minkler, and I am pleased to be here today on behalf of the Independent Insurance Agents & Brokers of America (IIABA) and to provide my association's perspective on the non-admitted insurer/reinsurance legislation that is the focus of this hearing. I am currently Chairman of the IIABA Government Affairs Committee. I am also President of Clark Mortenson, a New Hampshire-based

independent agency that offers a broad array of insurance products to consumers and commercial clients in New England and beyond.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and employees. IIABA represents independent insurance agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance – property, casualty, life, health, employee benefit plans, and retirement products.

**IIABA Commends H.R. 5637 as the Right Approach**

IIABA commends Congresswoman Brown-Waite, Congressman Moore, Chairman Baker, and all who worked on drafting this legislation. We believe that overall the bill is the right approach and we are happy to support it, and we look forward to working with the Subcommittee and Committee as you continue your review of the legislation.

In particular, this legislation preserves the state system of insurance regulation while achieving much-needed uniformity. Virtually every sector — insurers, producers, consumers and even regulators themselves — has voiced significant concerns with the inefficient patchwork of different laws and regulations that characterize the current regulatory system. Although we also believe that the current state-based insurance regulatory system is in need of greater efficiency and uniformity, IIABA opposes constructing a completely new regulatory scheme at the federal level through mandatory or optional federal regulation. A new, federal insurance regulatory system would

dismantle the inherent strengths of state regulation, namely diversity, geographical uniqueness, innovation and responsiveness to consumers.

IIABA believes the best use of federal legislative authority is to help make the existing state system more efficient and uniform through a mix of national standards with state enforcement and uniformity achieved through both incentives and preemption of certain state laws. This approach offers the best solution because it will promote more uniform standards and streamlined procedures from state to state; protect consumers and enhance marketplace responsiveness; and emphasize that oversight can best be met by improving the state-based system. The result for all stakeholders would be a more efficient, modern and workable system of state regulation.

The SMART draft of two years ago would have tackled most aspects of the insurance regulatory system all at once. In contrast, the Nonadmitted and Reinsurance Reform Act of 2006 would single out two areas – surplus lines regulation and reinsurance supervision – where there is general consensus for early action. We support this step-by-step approach to achieve reform. While IIABA is eager also to have Congress address the need for uniformity and streamlining in producer licensing as well as other reform areas, we strongly support the general approach taken in H.R. 5637 and applaud the sponsors and the Subcommittee, respectively, for introduction and the prompt hearing on the matter.

#### **Role of Agents & Brokers in the Nonadmitted Insurance Market**

Nonadmitted, or surplus lines, insurance provides coverage for unique or hard to place property and casualty risks when unavailable or unaffordable in the traditional, licensed or "admitted" insurance market. The role of independent insurance agents and

brokers in the nonadmitted market is just as important as their role in the overall insurance market. Independent insurance agents and brokers invest substantial effort to identify policyholders' wants and needs; understand the complex terms of policies available; assess the products available and present choices to the consumer about coverage, price, service, and financial strength of carriers; and remain available to assist with any questions and changes as needed.

IIABA believes that continued state supervision of this market is necessary to ensure that the nonadmitted marketplace continues to function as the "safety-valve" for the overall insurance market for hard-to-place risks. Nevertheless, the current state-based regulatory scheme is burdened by inefficiencies that disrupt the non-admitted marketplace with respect to the allocation and remittance of premium taxes, licensing of nonresident agents and brokers, and duplicative regulation of the nonadmitted market generally.

#### **Need for Uniformity in Premium Tax Allocation and Remittance**

Premium tax allocation and remittance schedules vary significantly from state to state. Surplus lines brokers are responsible for determining which state's allocation formula governs a transaction involving a multi-state surplus lines risk. State surplus lines laws require that a licensed surplus lines agent or broker placing coverage remit taxes to the state on the portion of premium allocated to that state. State laws do not, however, contain mechanisms for the remittance of premium taxes to other states. Moreover, nonresident surplus lines agents and brokers have no guidance on which state surplus lines laws govern multi-state surplus transactions. As a result of the lack of a universally applicable allocation formula for multi-state risks and sufficient guidance on

which state's laws govern a multi-state surplus lines transaction, surplus lines agents and brokers attempting to comply with lawful requirements of the various states often are caught between conflicting rules and claims on premium tax revenues. At best, the confusion and conflicts result in inefficiencies and expenses which ultimately affect policyholders in addition to the producing agents and brokers.

ILABA supports the Nonadmitted Insurance and Reinsurance Reform Act of 2006 because it eliminates this confusion. Under the bill, a surplus licenses licensee (the broker accessing the nonadmitted market) need only remit premium taxes to the home state of the insured, and if requested, a report of the location and insured values of properties and risks by states covered under the policy being placed. The states then determine how the taxes will be allocated, either by compact or by other procedures developed by the states, and in each case using the allocation information provided by the surplus lines broker.

#### **First Step in Uniformity in Producer Licensing**

Surplus lines agents and brokers engaging in transactions that involve multi-state risks currently must obtain and maintain general agent or broker licenses and surplus lines licenses in many if not every jurisdiction in which the exposures are located. Some states require that these agents and brokers obtain and maintain corporate licenses as well. This means that a surplus lines broker or agent could potentially be required to obtain and maintain up to 100 separate licenses in order to handle a single multi-state surplus lines transaction. Moreover, each state has different licensing requirements and renewal schedules. These duplicative licensing requirements cause administrative burdens which impede the ability of agents and brokers to effectively and efficiently

service their customers' policies. Perhaps most importantly, these onerous licensing requirements create expenses which ultimately impact policyholders. The Nonadmitted Insurance and Reinsurance Reform Act alleviates the burdens of duplicative licensing requirements by encouraging states to participate in a national insurance producer database without diminishing the quality and expertise of the surplus lines insurance distribution channel.

#### **Uniformity in Surplus Lines Regulation**

Surplus lines agents and brokers must typically comply with the laws and regulations of multiple states with respect to coverage for multi-state risks. As a result of the lack of sufficient guidance on which state law governs a multi-state surplus lines placement, agents and brokers who have obtained nonresident surplus lines licenses find themselves attempting to comply with the surplus lines laws of every applicable state. These agents and brokers are subject to multiple tax filings, multiple diligent search requirements (which vary from state to state), multiple regulatory filings, and multiple information notices on the declarations page or policy, among other duplicative regulatory requirements.

The Nonadmitted Insurance and Reinsurance Reform Act effectively streamlines surplus lines regulation by making the insured's home state the source of regulation for individual surplus lines transactions. In addition, the Act streamlines access to the surplus lines market by waiving state due diligence requirements for the sophisticated commercial entities that constitute a significant portion of policyholders in this market.



The bill also has a second title that would, in much the same way as the nonadmitted insurance title, seek to reduce overlapping, multiple-state regulation of both reinsurer financial condition – making one NAIC-accredited state responsible for each reinsurer – and credit-for-reinsurance on the balance sheets of ceding insurers. While, IIABA is less directly concerned with this title, except to the extent some of our members serve as brokers of outward reinsurance programs, we nevertheless note and applaud that this reinsurance title also seeks to retain and improve state regulation rather than create a federal regulator.

### **Conclusion**

The IIABA applauds the sponsors and urges the Subcommittee to promptly act on the Nonadmitted Insurance and Reinsurance Reform Act of 2006, which IIABA believes is an excellent example of a pragmatic reform approach that utilizes targeted, federal tools to improve the state-based regulatory system. We are also hopeful that this approach will be used in the near future to facilitate additional reforms in the state-based system of insurance regulation, particularly regulation of producer licensing. Thank you again for the opportunity to testify.

**RAA**  
REINSURANCE  
ASSOCIATION  
OF AMERICA

STATEMENT

TESTIMONY

OF

**FRANKLIN W. NUTTER, PRESIDENT  
REINSURANCE ASSOCIATION OF  
AMERICA**

**COMMERCIAL INSURANCE  
MODERNIZATION**

BEFORE

**THE SUBCOMMITTEE ON CAPITAL  
MARKETS, INSURANCE, AND GOVERNMENT  
SPONSORED ENTERPRISES**

**JUNE 21, 2006**

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My name is Frank Nutter and I am President of the Reinsurance Association of America. It is an honor to appear before you on behalf of the RAA. The RAA is a national trade association representing property and casualty organizations that specialize in reinsurance. The RAA membership is diverse, including U.S. companies and U.S. subsidiaries of foreign companies. Together, RAA members underwrite nearly 2/3 of the gross reinsurance coverage provided by U.S. property and casualty reinsurers and affiliates.

I am pleased to testify today on "H.R. 5637, legislation to streamline the regulation of nonadmitted insurance and reinsurance." The RAA supports the principles set forth in the legislation and will highlight the key provisions that will help modernize and make reinsurance regulation more efficient. My testimony will address: 1) the reinsurance role in the marketplace, 2) U.S. reinsurance regulation, 3) the extra-territorial application of state law provision, 4) the solvency regulation provision and 5) the credit for reinsurance provision.

**Reinsurance Role in the Marketplace:**

Reinsurance is a transaction by which one insurance company indemnifies, for a premium, another insurance company against all or part of the loss that it may sustain under its policies of insurance. The insurance company purchasing the reinsurance is known as the ceding insurer; the company selling reinsurance is known as the assuming insurer, or, more simply, the reinsurer. Described as insurance for insurance companies, reinsurance provides reimbursement to the ceding insurer for losses covered in the reinsurance agreement. Reinsurance is a contract between sophisticated parties; there is

no consumer element to the reinsurance transaction. The fundamental objective of insurance, to spread risk so that no single entity finds itself saddled with a financial burden beyond its ability to pay, is enhanced by reinsurance.

Reinsurance is a key component of the insurance marketplace, reducing volatility experienced by insurers, and improving insurers' financial performance and security. It is widely recognized that reinsurance performs at least four primary functions in the marketplace: to limit liability on specific risks; to stabilize loss experience; to protect against catastrophes; and to increase insurance capacity. Although considerably smaller than the U.S. insurance industry in premiums and capital, the global reinsurance industry has significantly responded to virtually every major U.S. catastrophe over the past century. For natural disasters typically one-third to one-half of the insured losses are passed on to reinsurers; in the events of September 11, 2001, two-thirds of the losses were absorbed by the global reinsurance industry.

#### **U.S. Reinsurance Regulation - Direct and Indirect**

Like insurance, reinsurance and U.S. based reinsurers are regulated by the states not the Federal government. U.S. states employ two methods of reinsurance regulation, both direct and indirect regulation.

Direct regulation is imposed on those reinsurers that opt to be licensed in the U.S. Reinsurers licensed in at least one U.S. jurisdiction are subject to the full spectrum of laws and regulations to which a primary insurer is subject including regulation for financial reporting and solvency. The exceptions to this general rule are rates and contracts. Because reinsurance is conducted between sophisticated parties of essentially

equal bargaining power, regulators do not impose regulatory requirements relating to the rates that can be charged for reinsurance or for the most part, the forms that can be used to evidence the contractual terms.

Recognizing that an insurance marketplace as large as that found in the U.S. is in need of a substantial amount of reinsurance capacity, U.S. regulators permit U.S. and non-U.S. reinsurers to assume business on risks located in the U.S.

The states have developed a system of indirect regulation where the reinsurance transaction is regulated through the credit for reinsurance mechanism. Credit for reinsurance is the financial statement accounting effect given to a ceding insurer if cessions are ceded in accordance with prescribed state criteria. If the criteria are met, the ceding insurer may record as an asset or a reduction in insurance liabilities for the effect of the reinsurance transaction. The fundamental concept underlying the U.S. regulatory view is that a reinsurer must either be licensed in a U.S. state and subject to a full spectrum of reinsurance regulation or, in lieu of regulation, provide security to ensure the payment of the reinsurer's obligations to ceding insurers. Credit for reinsurance is the cornerstone of reinsurance regulation.

#### **Extraterritorial Application of Law**

The RAA applauds Representatives Brown-Waite and Moore for addressing a key improvement in the efficiency of regulation of reinsurers: the elimination of the extraterritorial application of state laws. As a result of our 50-state system of regulation, significant differences have emerged among the states with respect to reinsurance regulatory requirements. The NAIC and state regulators are to be applauded for their

efforts toward greater uniformity in the adoption of model laws and regulations and the creation of a system of accreditation for states to meet minimum standards for regulation. Unfortunately, this has not prevented states from pursuing varying and sometimes inconsistent regulatory approaches to reinsurance. One of the best examples of this phenomenon is the extraterritorial application of state laws.

Approximately 14 states apply their laws on an extraterritorial basis, meaning that the state law not only applies to insurers domiciled in that state but to insurers domiciled in other states if the extraterritorial state has granted a license to the insurer. For example, if a reinsurer domiciled in Ohio were entering into a contract with an insurance company domiciled in Massachusetts and either or both were licensed in other states, the reinsurer and insurer would abide by the Ohio and Massachusetts reinsurance requirements, but also to the reinsurance requirements of all other states that apply their laws on an extraterritorial basis. This is the case even if the contract between the reinsurer and ceding insurer does not have any risks associated with that particular state. Because reinsurance contracts are customarily written on a multi-state basis, it is inefficient and unnecessary to require the contracting parties to meet the legal regulatory and peculiarities of multiple jurisdictions for a single reinsurance transaction.

The RAA strongly supports the principle set forth in Title II, Section 201 that addresses these inefficiencies. This provision retains the ability of state insurance regulators to regulate their domestic insurers and reinsurers and the reinsurance transactions of their domestic insurance companies. The Act simply preempts the extraterritorial application of state law and articulates the types of laws that states cannot apply on an extraterritorial basis, including critical elements of the reinsurance

transaction, such as dispute resolution, governing law and requiring specific contract provisions. This provision will remove the burdensome and redundant requirements on the reinsurance transaction and will greatly improve efficiency.

### **Reinsurance Solvency Regulation**

The RAA supports the principles set forth in Title II Section 202 that provides that the state of domicile of a reinsurer shall be solely responsible for regulating the financial solvency of the reinsurer if the state is an NAIC accredited state. The financial integrity and solvency of a reinsurer is a key factor in determining whether insurance companies should receive credit for reinsurance on their financial statements. Redundant and burdensome solvency regulation may affect where the reinsurance market deploys its capital and increases the transaction costs for insurers, and ultimately consumers. The Act eliminates duplicative solvency regulation of reinsurers by placing sole responsibility for solvency regulation on the reinsurers' home state regulator. The Act protects against a "race to the bottom" for solvency regulation by requiring that the home state must meet the accreditation standards set out by the NAIC. We would recommend that the statute also recognize states that substantially meet accreditation requirements.

Reinsurance is a global marketplace. Allowing the state of domicile of the reinsurance company to be the single regulator for solvency will help streamline reinsurance regulation significantly and will add much to the value of a U.S. license. The home state of the reinsurer will still be subject to the very stringent NAIC accreditation standards for solvency regulation. Because the NAIC requires that accreditation laws be

“substantially similar,” all accredited states have the same basic solvency protections and laws in place even if they may differ in some of the details.

The elements of reinsurance solvency regulation that all states require and will stay in place under the proposed legislation include: Conservative statutory accounting rules, minimum reserve standards, annual actuarial opinion requirements, detailed financial reporting on the annual statement and quarterly statement blanks, annual Certified Public Accounting audit reports, minimum capital requirements per the NAIC risk-based capital formula, state investment laws that provide minimum diversification and limits on investments, holding company laws for extraordinary dividends and intergroup transactions, and many other model laws that are required for accreditation. The NAIC accreditation system will still require the home state regulator to demonstrate how effectively the state enforces its solvency regulation standards. This includes how well the state performs desk audits, examinations, whether they take timely action when needed, that they have qualified staff and other review requirements.

Strong reinsurance solvency regulation is critical to the health of the insurance marketplace. This legislation keeps reinsurance solvency regulation intact. It does relieve the reinsurer from having to file supplemental and at times inconsistent financial information in as many as 50 states. Yet, it provides all states with access to financial information on a U.S. licensed reinsurer. This streamlined regulation will allow U.S. reinsurers to compete more effectively without compromising solvency regulation.



**Credit For Reinsurance**

The RAA supports the principle set forth in Section 202(b)(3) that the credit requirements of the domicile of the reinsurer should be exclusively applied to allow the ceding insurer to take financial statement credit in all other states. To achieve uniformity in the ceding companies financial statement requires a single state's credit statutes to apply. The NAIC's accreditation system and model credit for reinsurance law seeks to achieve this result. Inconsistent state implementation of the model has undermined that goal. This statutory provision will achieve the uniformity needed by ceding insurers and reinsurers.

**Conclusion**

The RAA supports this legislation and stands ready to work with Members of the House Financial Services Committee in moving it forward. As the Committee prepares to mark up this legislation, we welcome the opportunity to provide additional comments on the legislation to ensure the legislation adheres to its stated intent. The U.S. reinsurance industry competes on a global stage and its transactions are between sophisticated parties. We believe that reinsurance regulatory reform will improve the value of a U.S. reinsurance license and strengthen financial regulation.

HEARING ON "COMMERCIAL INSURANCE MODERNIZATION"  
 STATEMENT BY JANICE OCHENKOWSKI  
 ON BEHALF OF THE RISK AND INSURANCE MANAGEMENT SOCIETY  
 BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND  
 GOVERNMENT SPONSORED ENTERPRISES  
 COMMITTEE ON FINANCIAL SERVICES  
 UNITED STATES HOUSE OF REPRESENTATIVES

RICHARD BAKER, CHAIR

June 21, 2006

Good afternoon Mr. Chairman and Members of the Subcommittee. My name is Janice Ochenkowski. I am the Vice-President for the Risk and Insurance Management Society (RIMS), which is the country's largest professional risk management organization. I am also a Senior Vice-President, Director of Global Risk Management for Jones Lang LaSalle, a global real estate and financial services company based in Chicago. I appreciate the opportunity to appear before you today on behalf of RIMS to speak about the issue of modernization of commercial insurance; specifically, the Nonadmitted and Reinsurance Reform Act of 2006.

RIMS is in a unique position to participate in this hearing, as we represent the commercial consumers of insurance. RIMS membership spans the country and consists of entities of all different industries and sizes, including 84 percent of the Fortune 500 companies, as well as approximately 950 "small businesses," those companies with less than 500 employees. Our members, corporations, public entities, and municipalities buy insurance and so have a strong view on how the process should proceed. RIMS member companies, which number roughly 4,000, support the modernization of commercial insurance.

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Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises  
Committee on Financial Services  
June 21, 2006*

In this increasingly competitive global marketplace, commercial insurance consumers, like myself, need choices, flexibility, and speed in the process of purchasing insurance. Operating throughout the country and the world as the primary insurance buyer for Jones Lang LaSalle, I am witness everyday to the numerous inefficiencies in the current United States state based insurance system. Commercial consumers should no longer have to struggle with a hobbled system; we should use the proposals within this bill to address current inefficiencies. I applaud the members of this subcommittee for presenting us with the Nonadmitted and Reinsurance Reform Act of 2006 as a meaningful blueprint for reform of surplus lines insurance.

RIMS believes the Nonadmitted and Reinsurance Reform Act of 2006 is necessary to address regulatory problems that are causing disruptions in the surplus lines insurance marketplace. Disruptions have a tendency to increase ineffectiveness and add costs. Specifically, there is confusion among agents and brokers placing surplus lines business about the process because states have various premium tax allocation and remittance schedules. For example, even the manner in which applicable taxes are sent to states varies. In some states, a broker or agent calculates and sends taxes to the state as part of his transaction service for a client. In other states, the broker may calculate the tax due, but I must send it; while in a third type of state, I must calculate and send taxes. My company is a commercial property manager and advisor, with the responsibility to buy insurance for almost 400 buildings in over 30 states. We collect premium from each property and send hundreds of premium checks to our broker, as ERISA law does not

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permit a licensed advisor to commingle client funds. Our broker separates premium from tax and returns some funds to us with advice on which states we have to send the taxes. A third series of checks is then issued by my firm to the appropriate states. There has to be a better way. Many states have also implemented licensing rules that discriminate against out of state agents and brokers, and also require our brokers to pay local brokers to stamp approval on an already negotiated insurance program. Furthermore, state declination rules impede access to the surplus lines marketplace.

RIMS experience is that in a free, open and transparent competitive market, risk managers will be able to negotiate the best rates and the best terms and conditions for coverages needed by their companies. Currently, surplus lines policies' rates and forms are not regulated by the states; however, we think it is prudent to include freedom from rate and form regulation for surplus lines policies in a federal statute governing commercial property and casualty insurance because it would promote a more competitive marketplace.

Some states require that before an insurance buyer can obtain insurance from the surplus lines market, a diligent search of authorized insurers must be made to determine if the insurance is available through an authorized insurer. This slows the procurement process, and, at times, adds costs that are eventually passed on to the purchasers. RIMS believes that commercial consumers should be allowed access to the surplus lines market through the best supplier for its markets, regardless of whether the supplier is authorized by that state. At least eight states have enacted provisions in their commercial lines

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insurance deregulation laws permitting certain commercial buyers automatic access through a licensed surplus lines broker to the surplus lines market, as well as to the admitted market.

The Nonadmitted and Reinsurance Reform Act of 2006 provides answers to problems commercial insurance buyers are experiencing in obtaining surplus lines insurance by placing authority in the home state of the insured. This bill will fix the inconsistent and contradictory rules that govern the surplus lines marketplace, and allow insurers and brokers to serve their clients more efficiently and effectively. The bill sets up a uniform system of premium tax remittance and allocation by establishing a clear requirement that all surplus lines premium taxes be paid to the insured's home state; the states can then determine how they want to allocate the premium tax. The bill also provides an exemption for sophisticated commercial policyholders who are more likely to have either unique or large risks for which surplus lines insurance is necessary and the necessary expertise to evaluate options. The exemption is appropriate for sophisticated buyers of insurance and is one of common sense as it allows such policyholders to bypass the regulatory hurdles currently imposed by the states which add no meaningful value to the process. RIMS plans to provide the subcommittee with some recommendations for improving the exemption provision.

In conclusion, RIMS strongly supports the Nonadmitted and Reinsurance Reform Act of 2006 and looks forward to working with your committee and the Congress on this important piece of legislation. Thank you for the opportunity to speak today. I

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Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises  
Committee on Financial Services  
June 21, 2006*

appreciate your time, interest, and leadership, and welcome any questions by the Subcommittee.

**Statement of  
Scott A. Sinder  
on behalf of  
The Council of Insurance Agents + Brokers**

**Before  
The Subcommittee on Capital Markets,  
Insurance and Government Sponsored Enterprises  
of  
The House Financial Services Committee  
Regarding  
Commercial Insurance Modernization  
June 21, 2006**

Good morning, Chairman Baker, Ranking Member Kanjorski and members of the Subcommittee. Thank you for the opportunity to testify before you today on behalf of the Council of Insurance Agents and Brokers (The Council) and thank you, Representative Brown-Waite and Representative Moore, for introducing the Nonadmitted and Reinsurance Reform Act of 2006 (the Reform Act). Commercial insurance regulatory modernization is essential if we are to have a dynamic commercial insurance marketplace that addresses the needs of commercial insureds for the 21<sup>st</sup> century. The Council believes the proposed legislation constitutes a significant step toward that end and supports it wholeheartedly.

The Council represents the nation's largest, most productive and most profitable commercial property and casualty insurance agencies and brokerage firms. Council members specialize in a wide range of insurance products and risk management services for business, industry, government, and the

public. Operating both nationally and internationally, Council members conduct business in more than 3,000 locations, employ more than 120,000 people, and annually place more than 80 percent – well over \$90 billion – of all U.S. insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

My testimony today will focus on insurance sold by non-admitted insurance carriers which encompasses “surplus lines” products placed through brokers and “independently procured insurance” in which the coverage is purchased directly by the insured without the aid of a broker. I will explain what these types of insurance are, describing the Byzantine State regulatory requirements that currently burden the surplus lines marketplace, and I will explain that the Reform Act will address those issues primarily by dictating that only an insured’s home State’s laws apply to such a placement, hugely benefiting surplus lines consumers, the insurance industry and the insurance marketplace as a whole, without sacrificing one iota of consumer protection.

### **Introduction**

The members of the Council commend you for holding this hearing and considering this important legislation. Broad-based insurance regulatory reform is critical for the long-term health of the industry and for maintaining a strong, vibrant insurance sector for the benefit of policyholders. Surplus lines and reinsurance are essential elements of the insurance marketplace and we support your efforts to initiate insurance regulatory modernization by focusing on these areas.

Although the State insurance regulators, through the National Association of Insurance Commissioners (NAIC), have attempted to institute regulatory reforms in surplus lines and other areas of insurance without federal involvement, the reality is that today’s marketplace demands far more dramatic action than the States alone are able to provide. The pace of financial services convergence and globalization are far outstripping the pace of reform efforts by State regulators and legislatures.



Competition and efficiency in the insurance industry lags behind other financial services sectors due to the regulatory inefficiencies and inconsistencies in the State insurance regulatory system, inefficiencies and inconsistencies that must be addressed if the insurance sector is going to be able to keep up with the pace of change in the rapidly-evolving global marketplace and thereby expand the insurance marketplace for the benefit of insurers, producers and consumers.

The Council regards itself as a pioneer within our industry with respect to regulatory modernization, though reform is a frustratingly long process. We formed our first internal committee to address the problems of interstate insurance producer licensing more than 60 years ago. Our efforts were finally rewarded, thanks to the leadership of this committee, with the enactment of the NARAB provisions of the Gramm-Leach-Bliley Act a few years ago – a first step on the road to insurance regulatory reform. The Reform Act is the next step on the road to modernization.

I want to emphasize at the outset that we are not advocating de-regulation of the non admitted insurance marketplace or any sort of reduction in consumer protections. What we are advocating – as we did with NARAB and producer licensing reform – is streamlining the current burdensome system of regulation, thereby doing away with the overlapping, conflicting rules that inhibit the non admitted marketplace and harm consumers. We believe that consolidating regulatory oversight into a single State – the insured’s home State – makes eminent good sense, as opposed to the current system in which 55 jurisdictions, some with only remote connections to the transaction, dictate how – and whether – a transaction is completed. The long-term effects of such reform on the marketplace will ultimately benefit the consumer. Easing regulatory burdens – without sacrificing protections – will increase surplus lines insurers’ capacity and improve availability of coverage for hard to insure risks such as national catastrophes and terrorism.

**I. “Non admitted” insurance provides an alternative to the traditional insurance marketplace but current regulatory requirements are preventing this marketplace from fully realizing its potential.**

Non admitted insurance provides coverage for unique, unusual or very large risks for which insurance is unavailable in the admitted market. A surplus lines product is an insurance

product sold by an insurance company that is not admitted to do business in the State in which the risk insured under the policy is located. In essence, the insured goes to wherever the insurance company is located to purchase the coverage. The insurer may be in another State, or it may be in Great Britain, Bermuda or elsewhere. Potential insureds can procure this insurance directly, but they generally do so through their insurance brokers. In short, "surplus lines" are: (1) insurance products sold by insurance carriers that are not admitted (or licensed) to do business in a State, (2) to sophisticated commercial policyholders located in that State, (3) for insurance coverages that are not available from insurers admitted (or licensed) to do business in that State.

Although surplus lines is considered to be "unregulated," in reality the surplus lines marketplace is subject to extensive State statutory and regulatory requirements that impede the effectiveness of the market and increase costs to surplus lines consumers. As described more fully below, updating these regulations and laws and encouraging use of alternative insurance markets would help to increase options and decrease costs for insurance consumers.

Surplus lines insurance is universally recognized as an important component of the commercial property and casualty insurance marketplace in all States, and commercial property and casualty business is done increasingly through the surplus lines marketplace. Surplus lines products tend to be more efficient and a better fit for commercial coverages because they can be tailored to the specific risk profiles of insured with specialized needs. This is particularly true during hard markets, like the one we have experienced for the last several years, in which high premium rates for property and casualty insurance posed serious problems for many mid-sized and larger commercial firms. Hard markets cause availability to decrease and the cost of coverage to increase. During these periods, insureds – notably sophisticated commercial insureds – are increasingly drawn to the appeal of alternatives to the traditional, regulated marketplace to expand their coverage options and hold down costs. Surplus lines insurance is just such an alternative.

Although the purchase of surplus lines insurance is perfectly legal in all States, the regulatory structure governing such coverage is a morass. When surplus lines activity is limited to a single State,

regulatory issues are minimal. When activity encompasses multiple States, however, full regulatory compliance is difficult, if not impossible. And I should note that multi-State surplus lines policies are the norm rather than the exception because surplus lines coverage is uniquely able to address the needs of insureds seeking coverage in more than one State. Thus, the difficulty of complying with the inconsistent, sometimes conflicting requirements of multiple State laws is a real problem. Simply keeping track of all the requirements can be a Herculean task. For example: Maryland and the District of Columbia require a monthly "declaration" of surplus lines business placed, but only require payment of premium taxes on a semi-annual basis; Virginia, in contrast, requires that a declaration be filed and taxes be paid quarterly; New Jersey has 36 pages of instructions for surplus lines filings, including a page discussing how to number the filings and a warning not to file a page out of sequence because that would cause a rejection of the filing and could result in a late filing.

As a general matter, State surplus lines regulation falls into five categories: (1) taxation; (2) declinations; (3) insurer eligibility; (4) regulatory filings; and (5) producer licensing and related issues.

**1. Taxes:** States have inconsistent and sometimes conflicting approaches regarding the allocation of premium taxes, which can lead to double taxation and confusion when a surplus lines policy involves multi-State risks.

- Single situs approach – 100% of the premium tax is paid to the insured's State of domicile or headquarters State. This approach is imposed by some States regardless of what percentage of the premium is associated with risks insured in the State. Virginia, for example, utilizes this rule.
- Multi-State approach – Premium tax is paid to multiple States utilizing some method of allocation and apportionment based upon the location of the risk(s). Because there is no coordination among the States on allocation and apportionment, determination of the amount of tax owed to each State is left to brokers and insureds. If a policy covers property insured in a single situs State and in an apportionment State, double taxation also is unavoidable. A majority of the States utilize this basic rule but the manner in which it is implemented (including the allocation formula) can vary wildly.

- No clear requirement – More than a dozen States that impose surplus lines premium taxes do not have statutory or regulatory provisions indicating the State's tax allocation method, leaving it up to the insured and the insured's broker to determine how to comply with the State law. In such States, determination as to whether any tax should be paid and whether the allocation of any such tax is permissible and appropriate is often based on informal guidance from State insurance department staff.

In addition to the near-impossibility of determining the correct allocation for surplus lines premium tax in a way that does not risk paying too much or too little tax, the differences among the States with respect to tax rates, tax exemptions, taxing authorities, and the timing of tax payments impose huge burdens on surplus lines brokers (who are responsible for paying the taxes if they are involved in the placement) and on commercial consumers, who must navigate these requirements on their own for placements that do not involve a broker and who ultimately bear the costs of not only the tax but the administrative costs of compliance in any event.

For example, State surplus lines premium tax rates range from about 1% to about 6%. In one State, Kentucky, surplus lines taxes are levied not at the State level but at the municipality level. Aon, a member of the Council, reports that in order to properly rate taxes in Kentucky, they have to access electronic maps to determine the city and county in which a risk is located. There are hundreds of cities and counties in the State. Some counties charge a tax in lieu of the city tax, some charge it in addition to the city tax, some charge the difference between the city and county taxes, and some do not charge a city or county tax.

The due dates for premium taxes vary even more widely across the States. Surplus lines premium taxes are due:

- annually on a date certain in some States; the dates vary from State to State, but include: January 1, January 31, February 15, March 1, March 15, April 1 and April 16;
- semi-annually in some States; again the dates vary, but include: February 1 and August 1, February 15 and August 15, and March 1 and September 1;
- quarterly in some States (generally coinciding with the standard fiscal quarters);

- monthly in some States; and
- 60 days after the transaction in some States.

The States also differ with respect to what is subject to the tax, what is exempt from the tax, whether governmental entities are taxed, and whether brokers' fees are taxed as part of or separately from the premium tax (if they are taxed at all). As you can see, determining the proper surplus lines tax payment for the placement of a multi-State policy is a daunting task.

**2. Declinations:** Most States require that an attempt be made to place coverage with an admitted insurer before turning to the surplus lines market. Some States specifically require that one or more licensed insurers decline coverage of a risk before the risk can be placed in the surplus lines market. If it is determined that a portion of the risk is available in the admitted market, many States require that the admitted market be used for that portion of the risk.

State declination requirements are inconsistent and conflicting, however, and the methods of proving declinations vary tremendously – from specific requirements of signed affidavits to vague demonstrations of “diligent efforts.” For example, Ohio requires 5 declinations, but does not require the filing of proof of the declinations. New Mexico requires 4 declinations and submission to the insurance department of a signed, sworn affidavit. Hawaii does not require declinations but prohibits placement of coverage in the surplus lines market if coverage is available in the admitted market. Further, Hawaii does not require filing of diligent search results, but requires brokers to make such information available to inspection without notice by the State insurance regulator. In California, prima facie evidence of a diligent search is established if the affidavit States that three admitted insurers that write the particular line of insurance declined the risk. In Alabama, the requirement is much more vague. The broker is required only to demonstrate “a diligent effort” but no guidance is provided suggesting what constitutes such an effort. In Connecticut, the broker must prove that only the excess over the amount procurable from authorized insurers was placed in the surplus lines market.

**3. Insurer Eligibility:** Most States require that a surplus lines insurer be deemed “eligible” by meeting certain financial criteria or having been designated as “eligible” on a State-maintained list.

Although a majority of the States maintain eligibility lists (also called “white lists”), in many of the remaining States the surplus lines broker is held responsible for determining if the non-admitted insurer meets the State’s eligibility criteria. In addition, although the NAIC maintains a list of eligible alien (non-U.S.) surplus lines insurers that is referenced by four States, this does not seem to have any bearing on the uniformity of the eligible lists in the remaining States. As one would expect, as a result of differing eligibility criteria from State to State – and changes in individual States from year to year – the insurers eligible to provide surplus lines coverage varies from State to State. This can make it exceedingly difficult to locate a surplus lines insurer that is “eligible” in all States in which placement of a multi-State policy is sought.

The flip side of insurer eligibility is also an issue: that is, when multi-State surplus lines coverage is placed with an insurer that is an admitted (not surplus lines) insurer licensed in one of the States in which part of the risk is located. This is problematic because surplus lines insurance cannot be placed with a licensed insurer. In these situations, more than one policy will have to be used, or the insured will have to use a different surplus lines carrier – one that is not admitted, but “eligible” in all States in which the covered risks are located.

**4. Filings:** Most States require one or more filings to be made with the State insurance department in connection with surplus lines placements. These may include filings of surplus lines insurer annual statements, filings regarding diligent searches/declinations, filings detailing surplus lines transactions, and filings of actual policies and other informational materials. Some States that do not require the filing of supporting documentation require brokers to maintain such information and make it available for inspection by the regulator.

Like other surplus lines requirements, State filing rules vary widely. Some States require signed, sworn affidavits detailing diligent search compliance; some require such affidavits to be on legal sized paper, others do not; some States require electronic filings, others require paper; some States have specific forms that must be used, others do not; some States require the filing of supporting documentation, some do not – although some of those States place the burden on the broker, who is required to store the information in case regulatory inspection is required. In addition, although most

filings are required to be submitted to the State insurance regulator, in at least one State, Kentucky, municipalities also require submission of surplus lines materials. There are hundreds of cities and counties in the State and each requires a separate quarterly and annual report by the licensee. As with the tax situation, this creates a terrible burden on surplus lines insurers and brokers, and unnecessarily increases consumer costs.

Depending on the State in question, filings can be required annually, quarterly, monthly or a combination thereof. For example, several States require the filing of surplus lines information in the month following the transaction in question: Colorado requires such filings by the 15<sup>th</sup> of the month; and the District of Columbia by the 10<sup>th</sup>. Other States peg the filing date to the date of the transaction or the effective date of the policy: Florida requires filing within 21 days of a transaction; Idaho within 30 days; Kansas within 120 days; Missouri requires filing within 30 days from the policy effective date and New York 15 days from the effective date; Illinois and Michigan require semi-annual filings of surplus lines transactions. Although Illinois does not require filing of affidavits, carriers must maintain records of at least three declinations from admitted companies for each risk placed in the surplus lines market. Some States have different deadlines for different filings. Louisiana, for example, requires quarterly filings of reports of all surplus lines business transacted, and “diligent search” affidavits within 30 days of policy placement. North Dakota, in contrast, requires a single annual filing of all surplus lines transactions, and allows 60 days for the filing of “diligent search” affidavits.

In addition, some States treat “incidental exposures” – generally relatively small surplus lines coverages – differently from more substantial coverages with respect to filing requirements. States have differing definitions of what constitutes incidental exposures and who has to make required filings for such an exposure: some States require the broker to make the filings; others the insured; and some require no filings at all for incidental exposures.

**5. *Producer Licensing and Related Issues:*** In addition to the substantial issues outlined above, there are other vexing regulatory issues facing the surplus lines marketplace:

- **Producer Licensing:** All States require resident and non-resident surplus lines producers to be licensed, and all States have reciprocal processes in place for non-resident licensure. Nevertheless, there remain significant differences among some States with respect to producer licensing that can delay the licensure process, particularly for non-residents. For example, most States require that an individual applying for a surplus lines broker license be a licensed property and casualty producer. The States vary, however, as to how long the applicant must have held the underlying producer license. In addition, some, but not all, States exempt from licensure producers placing multi-State coverage where part of the risk is located in the insured's home State. In States without such an exemption, the laws require a producer to be licensed even for such incidental risks.
- **Sophisticated Commercial Policyholders:** Some States exempt "industrial insureds" from the diligent search, disclosure, and/or filing requirements. The definition varies among the States, but generally industrial insureds are analogous to the concept of sophisticated commercial insureds. They are required to have a full time risk manager, minimum premium requirements for selected lines of coverage, and a minimum number of employees. If an insured meets a State's criteria, the insured's surplus lines transaction is exempt from the surplus lines requirements, as provided for by the State.
- **Automatic Export:** A number of States allow certain risks to be placed directly in the surplus lines market. This is called "automatic export" because no diligent search is required before the risk is exported from the admitted market to the surplus lines market. As with every other surplus lines requirement, however, the States are not uniform in their designation of the risks eligible for automatic export.
- **Courtesy Filings:** A courtesy filing is the payment of surplus lines tax in a State by a surplus lines broker who was not involved in the original procurement of the policy. Courtesy filings are helpful when a broker places a multi-State filing that covers an incidental risk in a State in which the broker is not licensed. The problem is that most States either prohibit courtesy filings or are silent as to whether they will be accepted. This uncertainty essentially requires surplus lines producers to be licensed even in States where they would otherwise be exempt.



**II. Congressional action is needed to address the unnecessarily burdensome and overlapping State regulatory requirements imposed on the surplus lines marketplace. The Reform Act achieves that goal without in any way diminishing consumer protections or regulatory effectiveness.**

The current surplus lines regulatory structure is not working. The overlapping, redundant, sometimes inconsistent State regulatory requirements described above fail to recognize current market realities – the great majority of surplus lines policies are placed on a multi-State basis and purchased by sophisticated commercial insureds who have unique risks that are not readily covered in the admitted market. The regulatory roadblocks erected by some States do nothing to improve the availability or affordability of insurance, nor do they protect surplus lines consumers. Indeed, we believe the current system causes significant disruptions in the surplus lines marketplace and increases costs for consumers.

The proposed Reform Act would fix the system. The legislation would streamline regulation and ease regulatory burdens, but without sacrificing consumer protections or a financially sound surplus lines marketplace, which is the most important consumer protection of all. The proposed legislation would provide an effective resolution to the current regulatory morass by focusing on the home State of the insured: all premium taxes would be payable to the insured's home State and surplus lines insurance transactions would be governed by the rules of the insured's home State.

This home State focus accomplishes several things:

- Home State regulation ensures that the insured is protected by the laws of its home State and the regulator with the greatest interest in its welfare. It is common sense to assume that a regulator will spend more time and effort on the needs of in-State constituents rather than non-residents with little or no stake in the State or its economy.
- Home State regulation is logical because the risks covered in the non admitted market are generally commercial lines and are not compulsory. We are not talking about auto or homeowners or individual life coverage. These are unique risks that the insured is not required to protect with insurance but chooses to do so to protect the corporate treasury. The corporate treasury, in turn, is not located in the multiple States where the insured has risks, but in the State in which the insured itself is located – generally its state of domicile.

- Home State regulation completely does away with the inconsistent, redundant, burdensome obligations that the current system imposes in connection with multi-State placements. All the regulatory issues described above – taxes, filings, diligent searches, insurer eligibility requirements, producer licensing and more – will be governed by the rules of a single State rather than being subject to multiple State rules.

On one level, the effect of this change is significant – it will eliminate mountains of red-tape and administrative costs, ultimately saving consumers time and money, and expanding the availability of coverage for unusual or extreme risks such as natural catastrophes and terrorism. On another level, however, the change will be minimal. The Reform Act does not alter the basic elements of State surplus lines regulation. Indeed, all of the substantive provisions in the proposed legislation can be found in current State laws and regulations. The beauty of the proposal is that it enables surplus lines producers to look to a single standard in a single State for each transaction. Although the standard may differ from transaction to transaction depending upon the home State of the insured, each individual transaction will have a single standard, rather than being subject to the standards of 55 different jurisdictions. Clearly, this will make multi-State compliance significantly less daunting.

The Reform Act would fix the current tax allocation problems by establishing a clear requirement that all surplus lines premium taxes be paid to the insured's home State. Surplus lines producers would pay the full amount of premium tax owed on an insurance transaction to the insured's home State. In addition to the tax, the home State could require the filing of an allocation report denoting the location of the covered risks. The States are then free to allocate the premium tax among themselves as they so determine. The contrast in approaches – from the convoluted, burdensome approach of the States to the simple straightforward approach in the Reform Act could hardly be greater.

Finally, the exemption for sophisticated commercial policyholders is a victory for common sense. The State regulators, in many of their model rules and regulations, recognize that streamlined processes make sense for sophisticated commercial policyholders, who have a greater understanding of their needs and the insurance marketplace than individual consumers. In addition, sophisticated commercial policyholders are more likely to have unique or large risks for which surplus lines coverage

is necessary. For these reasons, it only makes sense to allow such policyholders to access the surplus lines market without jumping through all the regulatory hoops that are currently imposed by some States.

#### **Conclusion**

In closing, I would once again like to thank you for taking on this important, if unglamorous, issue. As my testimony has demonstrated, reform of the surplus lines insurance regulatory system is badly needed to maintain a competitive marketplace and, more importantly, to enable insurers and producers to provide insurance consumers with the coverages they need to protect themselves and their businesses from the risks inherent in today's world. As I said at the outset, the Reform Act will get the job done and the Council looks forward to working with you to get it enacted into law.

# # #

**ARIZONA** Pursuant to Arizona Revised Statutes section 20-401.01, subsection b, paragraph 1, this policy is issued by an insurer that does not possess a certificate of authority from the director of the Arizona Department of Insurance. If the insurer that issued this policy becomes insolvent, insureds or claimants will not be eligible for insurance guaranty fund protection pursuant to Arizona Revised Statutes Title 20.

Gross Premium \$	_____
Other Fees \$	_____
Premium Subject to Tax \$	128.49
Surplus Lines Tax \$	3.85
Stamping Fee \$	.32
Total \$	132.66

**CALIFORNIA NOTICE:**

- 1. THE INSURANCE POLICY THAT YOU (HAVE PURCHASED) (ARE APPLYING TO PURCHASE) IS BEING ISSUED BY AN INSURER THAT IS NOT LICENSED BY THE STATE OF CALIFORNIA. THESE COMPANIES ARE CALLED "NONADMITTED" OR "SURPLUS LINE" INSURERS.**
- 2. THE INSURER IS NOT SUBJECT TO THE FINANCIAL SOLVENCY REGULATION AND ENFORCEMENT WHICH APPLIES TO CALIFORNIA LICENSED INSURERS.**
- 3. THE INSURER DOES NOT PARTICIPATE IN ANY OF THE INSURANCE GUARANTEE FUNDS CREATED BY CALIFORNIA LAW. THEREFORE, THESE FUNDS WILL NOT PAY YOUR CLAIMS OR PROTECT YOUR ASSETS IF THE INSURER BECOMES INSOLVENT AND IS UNABLE TO MAKE PAYMENTS AS PROMISED.**
- 4. CALIFORNIA MAINTAINS A LIST OF ELIGIBLE SURPLUS LINE INSURERS APPROVED BY THE INSURANCE COMMISSIONER. ASK YOU AGENT OR BROKER IF THE INSURER IS ON THAT LIST.**
- 5. FOR ADDITIONAL INFORMATION ABOUT THE INSURER YOU SHOULD ASK QUESTIONS OF YOUR INSURANCE AGENT, BROKER, OR "SURPLUS LINE" BROKER OR CONTACT THE CALIFORNIA**

**INDIANA** Indiana does not require any language to be stamped on the policy; however, the declarations page of each policy must indicate as separate amounts all charges for taxes, fees and premiums.

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ \_\_\_\_\_  
 Premium Subject to Tax \$ 279.71  
 Surplus Lines Tax \$ 0.99  
 Stamping Fee \$ \_\_\_\_\_  
 Total \$ 240.70

### LOUISIANA

NOTICE: This insurance policy is delivered as a surplus line coverage under the insurance code of the State of Louisiana. In the event of the insolvency of the company issuing this contract, the policyholder or claimant is not covered by the Louisiana Insurance Guaranty Association which guarantees only specific policies issued by an insurance company authorized to do business in Louisiana. This surplus lines policy has been procured by the following licensed Louisiana surplus lines broker:

*Shawn Z. Rain*

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ \_\_\_\_\_  
 Premium Subject to Tax \$ 2204.95  
 Surplus Lines Tax \$ 113.25  
 Stamping Fee \$ \_\_\_\_\_  
 Total \$ 2378.20

**MARYLAND** This insurance is issued by a nonadmitted insurer not under the jurisdiction of the Maryland Insurance Commissioner.

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ \_\_\_\_\_  
 Premium Subject to Tax \$ 51019.07  
 Surplus Lines Tax \$ 1108.59  
 Stamping Fee \$ \_\_\_\_\_  
 Total \$ 5288.26

**MISSISSIPPI** "NOTE: This insurance policy is issued pursuant to Mississippi law covering surplus lines insurance. The company issuing the policy is not licensed by the State of Mississippi, but is authorized to do business in Mississippi as a nonadmitted company. The policy is not protected by the Mississippi Insurance Guaranty Association in the event of the insurer's insolvency."

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ \_\_\_\_\_  
 Premium Subject to Tax \$ 770.33  
 Surplus Lines Tax \$ 30.81  
 Stamping Fee \$ 1.93  
 Total \$ 803.07

**NEVADA** This insurance contract is issued pursuant to the Nevada insurance laws by an insurer neither licensed by nor under the supervision of the department of business and industry of the State of Nevada. If the insurer is found insolvent, a claim under this contract is not covered by the Nevada Insurance Guaranty Association Act.

Gross Premium \$	_____
Other Fees \$	25.00
Premium Subject to Tax \$	1334.31
Surplus Lines Tax \$	40.70
Stamping Fee \$	_____
Total \$	1400.01

**NEW HAMPSHIRE** "The company issuing this policy has not been licensed by the state of New Hampshire and the rates charged have not been approved by the Commissioner of Insurance. If the company issuing this policy becomes insolvent, the New Hampshire Insurance Guaranty Fund shall not be liable for any claims made against the policy."

Gross Premium \$	_____
Other Fees \$	25.00
Premium Subject to Tax \$	839.04
Surplus Lines Tax \$	10.79
Stamping Fee \$	_____
Total \$	861.43

**NEW YORK** THIS IS NOT AN INSURANCE POLICY AND THE INSURER (INSURERS) HEREIN REFERRED TO IS (ARE) NOT LICENSED BY THE STATE OF NEW YORK AND NOT SUBJECT TO ITS SUPERVISION. THE INSURANCE CONFIRMED HEREIN, IN THE EVENT OF THE INSOLVENCY OF THE INSURER (INSURERS), IS NOT PROTECTED BY THE NEW YORK STATE SECURITY FUNDS. THE POLICY MAY NOT BE SUBJECT TO ALL OF THE REGULATIONS OF THE INSURANCE DEPARTMENT PERTAINING TO POLICY FORMS.

Gross Premium \$	_____
Other Fees \$	_____
Premium Subject to Tax \$	8102.69
Surplus Lines Tax \$	311.86
Stamping Fee \$	25.99
Total \$	9000.54

**OREGON** This is evidence of insurance procured and developed under the Oregon surplus lines laws. It is NOT covered by provisions of ORS 734.510 to 734.710 relating to the Oregon Insurance Guaranty Association. If the insurer issuing this insurance becomes insolvent, the Oregon Insurance Guaranty Association has no obligation to pay claims under this evidence of insurance.

Gross Premium \$	37.32
Other Fees \$	_____
Premium Subject to Tax \$	3731.09
Surplus Lines Tax \$	24.03
Stamping Fee \$	9.33
Total \$	3852.97

**PENNSYLVANIA** "The insurer which has issued this insurance is not licensed by the Pennsylvania Insurance Department and is subject to limited regulation. This insurance is NOT covered by the Pennsylvania Property and Casualty Insurance Guaranty Association."

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ 15.00  
 Premium Subject to Tax \$ 28009.09  
 Surplus Lines Tax \$ 842.09  
 Stamping Fee \$ \_\_\_\_\_  
 Total \$ 28970.78

**TENNESSEE** This insurance contract is with an insurer not licensed to transact insurance in this state and is issued and delivered as a surplus lines coverage pursuant to the Tennessee insurance statute

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ \_\_\_\_\_  
 Premium Subject to Tax \$ 1075.49  
 Surplus Lines Tax \$ 34.95  
 Stamping Fee \$ \_\_\_\_\_  
 Total \$ 1110.44

**UTAH** The insurer issuing this policy does not hold a certificate of authority to do business in this state and thus is not fully subject to regulation by the Utah Insurance Commissioner. This policy receives no protection from any of the guaranty associations created under Title 31A, Chapter 28.

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ \_\_\_\_\_  
 Premium Subject to Tax \$ 871.09  
 Surplus Lines Tax \$ 37.02  
 Stamping Fee \$ 2.18  
 Total \$ 1010.29

**VERMONT** "The company issuing this policy has not been licensed by the state of Vermont and the rates charged have not been approved by the commissioner of insurance. Any default on the part of the insurer is not covered by the Vermont Insurance Guaranty Association."

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ 50.00  
 Premium Subject to Tax \$ 210.98  
 Surplus Lines Tax \$ 8.01  
 Stamping Fee \$ \_\_\_\_\_

**WASHINGTON** This contract is registered and delivered as a surplus line coverage under the insurance code of the State of Washington, enacted in 1947. It is not issued by a company regulated by the Washington state insurance commissioner and is not protected by any Washington state guaranty fund law.

Gross Premium \$ \_\_\_\_\_  
 Other Fees \$ \_\_\_\_\_  
 Premium Subject to Tax \$ 4350.03  
 Surplus Lines Tax \$ 87.13  
 Stamping Fee \$ 17.43  
 Total \$ 4461.19

**WEST VIRGINIA** THIS COMPANY IS NOT LICENSED TO DO BUSINESS IN WEST VIRGINIA, AND IS NOT SUBJECT TO THE WEST VIRGINIA INSURANCE GUARANTY ACT.

	Gross Premium \$	
	Other Fees \$	30.42
Surcharge	Premium Subject to Tax \$	3041.51
	Surplus Lines Tax \$	121.66
	Stamping Fee \$	
	Total \$	3193.59



**6/1/06 Property Renewal**

- \* premiums exclude tobacco
- \*\* premiums allocate 10% to tobacco which playing in me



American Association of Independent Claims Professionals

**American Association of Independent Claims Professionals (AAICP)**

**Statement for the Record**

**House Financial Services Committee, Subcommittee on Capital  
Markets, Insurance and Government Sponsored Enterprises  
Hearing on “Commercial Insurance Modernization”  
Wednesday, June 21, 2006**

**Support for Congresswoman Brown-Waite and Congressman Moore’s Efforts:**

The American Association of Independent Claims Professionals (the AAICP) strongly supports legislative efforts to untangle the web of varying state insurance laws that have left consumers and the industry tied up in knots. Congresswoman Brown-Waite and Congressman Moore have taken an important step with their new legislation to promote more uniform, streamlined state regulation of non-admitted insurance and reinsurance.

Since independent claims adjusters work with non-admitted insurers and reinsurers on a regular basis, we know how helpful such reforms will be for those areas of the industry. In fact, independent adjusters seek the same sort of increased national standardization that the Brown-Waite/Moore legislation currently provides for non-admitted insurers and reinsurers.

**Independent Insurance Adjusting and the AAICP:**

Before commenting in more detail, let us describe the role of independent adjusters in the insurance industry and the makeup of the AAICP. America’s independent claims adjusting industry services millions of claims each year, employing thousands of Americans in offices throughout the country. In fact, independent adjusters are involved in the majority of the nation’s insurance claims.

Independent claims adjusters are frequently among the first to respond when Americans experience loss. Despite the emotionally charged atmosphere in which they often find themselves, independent claims adjusters strive to return victims’ lives to normal through fair, rapid claims payments. Adjusters evaluate the extent of the loss, obtain statements from witnesses and victims, identify and preserve pertinent physical and testimonial evidence, and discuss settlement terms.

Again, independent claims adjusters often partner with non-admitted insurers and reinsurers. Commercial entities that self-insure or have very high deductibles often choose to engage independent claims adjusters. At the same time, many more standard insurance carriers engage independent adjusters as an efficient, effective alternative or supplement to in-house adjusters. Furthermore, given their tight budgets and personnel shortages, state, local, and Federal relief agencies frequently depend upon independent adjusters.

The AAICP is an association that works to help independent claims professionals meet their responsibilities to claimants and claim funders alike, including by advocating for beneficial reforms in the public policy arena. Together, the AAICP's members, GAB Robins North America, Gallagher Bassett Services, Inc., Cunningham Lindsey, Asurion, and Sedgwick Claims Management Services, have approximately 10,000 employees and 800 offices nationwide.

#### **Advancing Needed Reforms:**

Congresswoman Brown-Waite and Congressman Moore rightly focus on fostering national compatibility of state insurance laws. Their bill prevents brokers and agents from effectively being taxed twice in the state-by-state tax allocation and remittance process. Representatives Brown-Waite and Moore adopt the NAIC Non Admitted Insurance Model Act to prevent state licensing rules from discriminating against out of state brokers and agents. They preclude extraterritorial application of state laws, in order to preserve the sanctity of reinsurance contracts.

This sort of improved national standardization is exactly the type of change that is needed in the insurance industry as a whole, including in the independent claims adjusting sector. Balanced, thoughtful Federal legislation is needed to spur reform. The problems of a patchwork of protectionist state laws, discriminatory licensure rules, arbitrary state actions, and conflicting scope of authority simply are not going away on their own, and the status quo is just not acceptable.

In the independent adjusting arena, several jurisdictions refuse to license non-resident adjusters. Furthermore, non-residents can run into problems even when a state accepts reciprocity. For example, New Hampshire allows for reciprocity, as long as adjusters are licensed in their home state. However, Massachusetts does not license adjusters. Therefore, an adjuster living in Massachusetts and wanting to adjust claims in New Hampshire would have to move to New Hampshire to be eligible for a license.

In addition, a number of other states mandate a physical business location within the state, even when the adjuster is an easy drive, phone call, or e-mail away. Moreover, in one state, licensure candidates must provide a certificate signed by "five reputable citizens of the community in which such applicant resides or transacts business, each of whom shall certify that he has personally known the person or individual for a period of at least five years..." This rule effectively denies licensure to new U.S. citizens or legal aliens, since the state refuses to consider certifications from such applicants' prior country of residence.

States also frequently apply their rules inconsistently or promulgate conflicting rules that further tie up adjusters. For instance, an adjusting firm located in a non-licensure state recently selected a specific jurisdiction to serve as an "alternative home state" for its staff's reciprocal licensure elsewhere. However, shortly after several of its adjusters passed the licensing exam, the state changed its policy and refused to issue home state certifications for the company's adjusters. As a result, the adjusters had to repeat the pre-licensing requirements and examinations to qualify in additional jurisdictions.

Furthermore, some jurisdictions offer a single independent adjuster license applicable to all covered types of insurance, but others provide for numerous separate adjuster licenses. This creates significant reciprocity problems. A New York adjuster with an independent adjuster's license for inland marine losses cannot simply adjust those types of claims in Washington State. Instead, the

adjuster must pass the Washington exam and qualify to adjust all types of claims, including workers' compensation, general liability, and the like, despite only wishing to adjust the sorts of inland marine losses for which he is already licensed in New York. In today's world of specialization, this approach makes little sense.

The Brown-Waite/Moore legislation takes an important step toward solving these types of problems. By proposing to break down state barriers for reinsurers and the non-admitted insurers with whom independent adjusters work, Representatives Brown-Waite and Moore have set the tone for further reforms. We must replicate this model for other parts of the industry, and we must do so now. Therefore, as the bill moves forward, we ask for legislative language to be included that improves cross-state compatibility for independent claims adjusters as well.



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Responses by the AAMGA to the  
Questions Received from Congresswoman Ginny Brown-Waite

*Q. Can a provider write in both the admitted and non-admitted markets?*

- A. A provider (insurer) may write in both admitted and non-admitted markets, depending on the licensing requirements in each state; if the insurer holds a Certificate of Authority in a state, it is an the admitted insurer. That Certificate of Authority will state the lines of business the insurer is authorized to write, and that in turn allows the insurer to write those lines of business on a non-admitted basis in any other state, if the insurer so chooses.

*Q. Do those who write in the non-admitted market tend to focus on a region or type of product or both?*

- A. Non-admitted insurers will usually provide insurance for any type of insurance they write. Some write on a regional basis only—these are usually the smaller insurers who are knowledgeable about their individual and surrounding states, as well as the residents and business residing there. Many of the surplus lines insurers write nationally, although develop their business plans by tying them to both underwriting expertise & perceived market opportunity.

Certain insurers do focus on a region or product, although more insurers usually seek diversity geographically and in coverages offered. They can concentrate on certain types of business, for instance property or coastal insurance only, or environmental insurance; most, however, will write insurance across the board, on an as-needed basis. They look for opportunities where the admitted market cannot or will not write the business, for whatever reason.

*Q. Are there examples of policies becoming so prevalent in the non-admitted market that they move into the admitted market?*

A. The surplus lines market is known for innovation & new product development. Because they do not have to file forms or rates, they can price the business based on free market competition, consumer need and according to how they think the business should be underwritten. The insurers can then adjust as their experience determines. The admitted market may then take note of the experience and development of that new line of insurance business. If they in turn believe the business can be written successfully, admitted insurers may then decide to enter the market. Employment Liability Insurance is a good example of this development.

It is a normal progression—the non-admitted insurers will introduce a new line, and the admitted insurers will enter it after the experience has “matured”.

*Q. Is there any reason a company would go into the non-admitted market if insurance is available in the admitted market?*

A. Yes; especially in the commercial world where so many policies must be written in order to properly insure the commercial business. One prevalent example is for capacity—usually an admitted insurer will lead the account, writing a \$1 million limit of liability general liability policy. But the insured company may require \$500 million limits for that general liability exposure; thus, a combination of admitted and non-admitted insurers will fill out the entire line to provide the \$500 million limit.

Secondly, an admitted insurer will often quote a policy, but will be unable to provide the insurance policy’s wordings to properly and completely insure the needs of the policyholder. A non-admitted insurer must be used to correctly and completely fill the insurance requirements for that insured. Thus, if an insured cannot obtain proper coverage through an admitted market, but for the abilities and capabilities of the surplus lines/non-admitted market doing so, the insured would not have the coverage and protection it requires.

Third, admitted insurance companies often utilize approved forms which they have drafted, or those written by the Insurance Services Office (ISO). Surplus lines/non-admitted carriers can write their own policies, endorsements and other aspects of the coverage on a manuscript basis to fully fit the needs of the insured, as opposed to providing a template approach to underwriting. This is another area in which the expertise of the surplus lines underwriter, risk management, claims and litigation administration, actuarial and reinsurance functions are a

very valuable component of the marketplace providing the needed experience to solve a company's risk problems.

***Q. If Congress makes the non-admitted market easier to navigate, would that encourage companies to go into that market, driving up costs for the policyholder and consumers?***

A. With all due respect, the non-admitted market is already easily navigated by the specialized surplus lines agents, brokers and companies concentrating in this market. We believe the best way forward now is for Congress to continue its effort toward uniformity and consistency through HR 5637—enabling the surplus lines brokers to pay taxes on multi-state business to the state in which the principle place of business for the commercial risk is located, and to override other states' conflicting surplus lines laws by specifying the insured's home state as governing the placement.

Each state has the same requirements (financial eligibility of insurers, diligent search of the admitted market, disclosure statements, tax transparency, etc.); they all differ only in their own specific procedures for complying with same. Passage of HR 5637 and allowing the surplus lines market to continue functioning as it has done successfully as a vital market to our Nation's infrastructure since the late 1800's will not drive up the cost of this insurance for either the policyholder or consumers. Rather, it is a necessary benefit that will benefit all aspects and parties to the insurance transaction.

***Q. By designating the policyholder's state of domicile the authority over tax and licensing measures, is Congress making it more difficult for those who live in states with stringent rules to obtain specialty insurance? Would this measure encourage insurance providers to write policies only in states with minimal coverage?***

A. The principal policyholder's domiciliary state is the key to the multi-state account. The first named insured on a policy is where the majority of the risk is located. The other states involved are usually the minority of the account. Thus, the governing state of the primary insured is the natural one whose state surplus lines laws should govern the entire placement.

This would not encourage anyone to "forum shop", either for tax payment or regulation—the first named insured's domiciliary state would govern. The surplus lines brokers are the legal licensees for non-admitted insurance, responsible for placing business correctly according to a state's surplus lines laws; those surplus lines brokers do not want to run afoul of state statutes and endanger losing their licenses or compromising their integrity.

*Q. If an insurance provider writes in more than one state, won't they still have a myriad of different regulations and tax schemes to follow? How would HR 5637 help?*

A. HR 5637 would help immensely by pegging the surplus lines laws of one state to govern the placement. Allocation of taxes is a matter of routine and practice for the national brokers who place most of this business. It will not invoke a "sea-change" of custom and practice; it will merely make the market more efficient, uniform and consistent.

HR 5637 would require those states to accept the domiciliary state's surplus lines laws, and that in itself would reduce the unnecessary compliance load of other states. It would also reduce the sheer number of states in which surplus lines brokers would have to hold a surplus lines license, as the broker would only have to be licensed in the domiciliary state(s) of his or her main commercial insureds.

We would add one final point for consideration: due to the impossibility of being able to pay taxes to certain states over the years, surplus lines brokers have accumulated those taxes in their trust accounts. We would suggest a "tax amnesty" period, in which states would accept those old taxes from the surplus lines brokers without question. That would give those states the old taxes they refused to accept and would allow the surplus lines brokers to begin with a clean slate. This could also be a substantial revenue stream for many states.

As you have said before, HR 5637 is a "common sense solution" to the surplus lines/non-admitted market, whose benefits will create greater strength, consumer and investor confidence and protect policyholders.

We appreciate the opportunity to provide responses to the questions raised, and will be pleased to continue working with you and the Committee Staff in not only facilitating the passage of this vital piece of legislation, but in advancing overall insurance modernization and reform efforts as well.

Respectfully submitted,



Bernd G. Heinze  
Executive Director





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August 1, 2006

Re: Representative Ginny Brown-Waite submitted additional questions.

Her questions and my responses follow:

#1. Do you think a federal role in the regulation of reinsurance would be needed?

The RAA believes that a single regulator for solvency and uniform application of law is appropriate. This could be accomplished at the federal level. Redundant or competitive regulation among the states or between a state and federal regulator would be unwelcome and inefficient.

#2. How does this bill address the problem of a reinsurer writing in more than one state and being subject to a myriad of regulations?

Reinsurance is customarily written on the basis of contracts covering a reinsured writing insurance in multiple states. Currently, some states seek to regulate the agreement beyond its domestic companies to include licensed companies. This is generally referred to as the extra-territorial application of state laws. This bill would provide that the state of domicile of the reinsured company would govern the contract terms and the domicile of the reinsurer would govern it for solvency regulation. The bill therefore addresses the competitive and sometimes conflicting regulatory overlay.

#3. Does putting regulation in the home state of the reinsurer does it encourage reinsurers to domicile in a state with the least regulation?

The bill addresses this concern by requiring the state of domicile to be accredited by the NAIC and therefore meet the threshold of laws and resources necessary to regulate for solvency. In addition the NAIC itself collects uniform financial information on all US entities, reviews it on the basis of financial ratios and triggers, applies risk based capital analysis and requires independent audits and actuarial opinions. Moreover, the NAIC has processes in place that involve state peer review of the financial solvency and regulation of financially significant insurers and reinsurers. In other words the bill relies on the states and NAIC's own rules, laws, reports and public disclosure to meet the necessary thresholds for satisfactory solvency regulation. While in theory there may be incentives to redomesticate to another jurisdiction, this is likely to be rare since the costs to redomesticate are high.